

# **NORTH CAROLINA TAX POLICY COMMISSION**



***INTERIM REPORT TO THE  
1999 GENERAL ASSEMBLY  
OF NORTH CAROLINA***

***2000 REGULAR SESSION***

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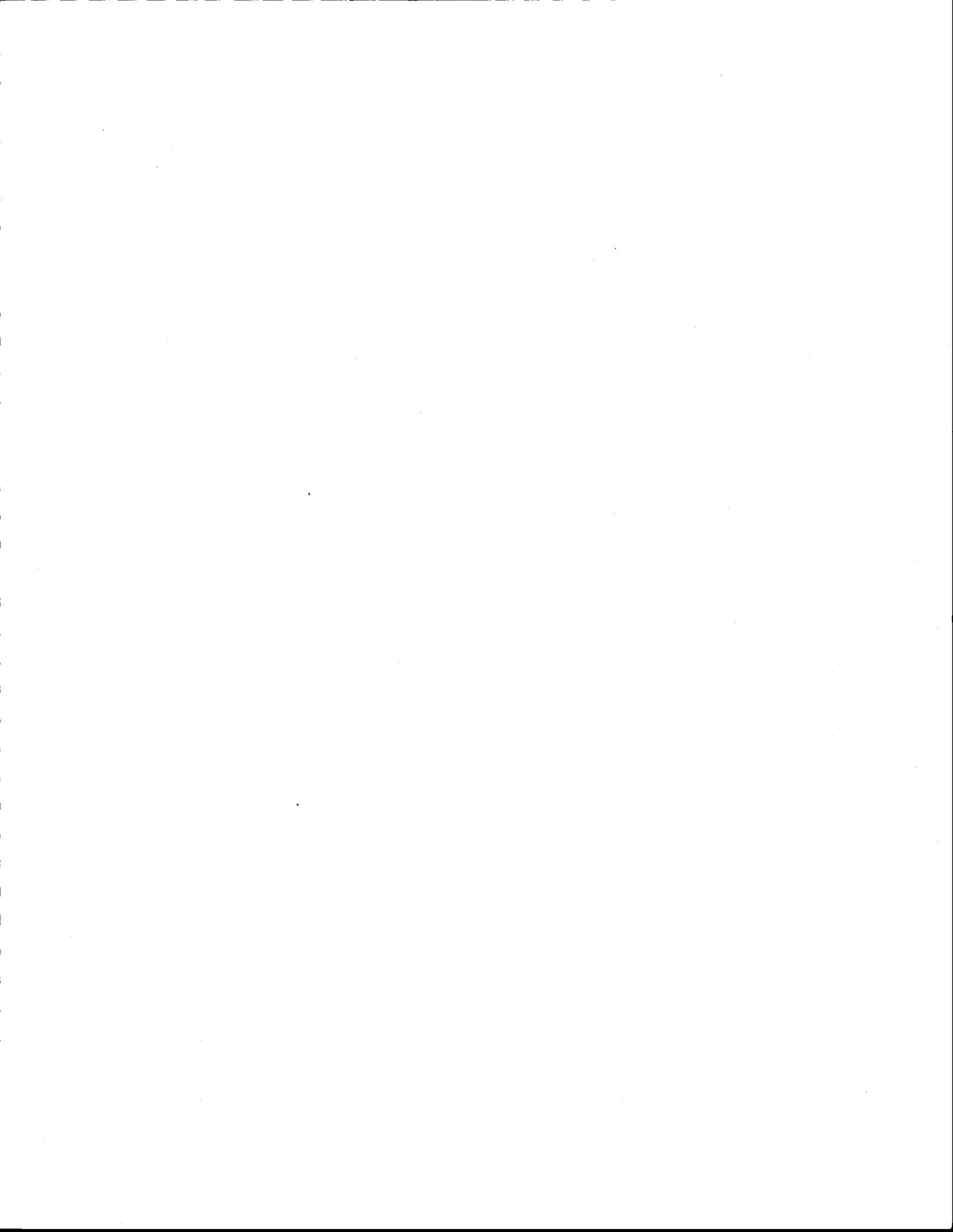
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## NORTH CAROLINA TAX POLICY COMMISSION

Senator David Hoyle, Co-Chair

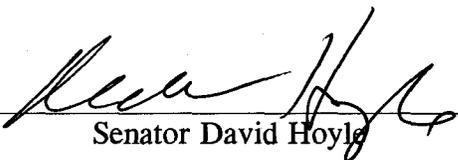
Representative George Miller, Jr., Co-Chair

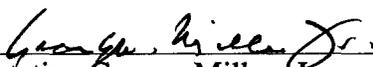
May 1, 2000

### TO THE MEMBERS OF THE 1999 GENERAL ASSEMBLY (REGULAR SESSION 2000):

The North Carolina Tax Policy Commission submits to you for your consideration its interim report pursuant to SL 99-395, Sec. 3.5.

Respectfully submitted,

  
\_\_\_\_\_  
Senator David Hoyle

  
\_\_\_\_\_  
Representative George Miller, Jr.

Co-chairs  
North Carolina Tax Policy Commission



**NORTH CAROLINA  
TAX POLICY COMMISSION**

**MEMBERSHIP**

*SL 99-395, Sec. 3.1*

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**President Pro Tempore's Appointments**

Sen. David Hoyle, Co-Chair

Mr. Park Helms

Sen. John H. Kerr, III

Ms. Helen Powers

Mr. Nathan Garrett

**Speaker's Appointments**

Rep. George Miller, Jr., Co-Chair

Rep. Gordon Allen

Dr. William Friday

Mr. Richard Gossin

The Honorable Brenda Oliver

**Governor's Appointments**

Sen. Daniel Clodfelter

Ms. Sabra Faires

Mr. Kelly Lumpkin

The Honorable James D. Phillips, Jr.

Mr. Robert Womble

**Commission Staff**

Cindy Avrette, Co-Counsel

Richard Bostic, Fiscal Analyst

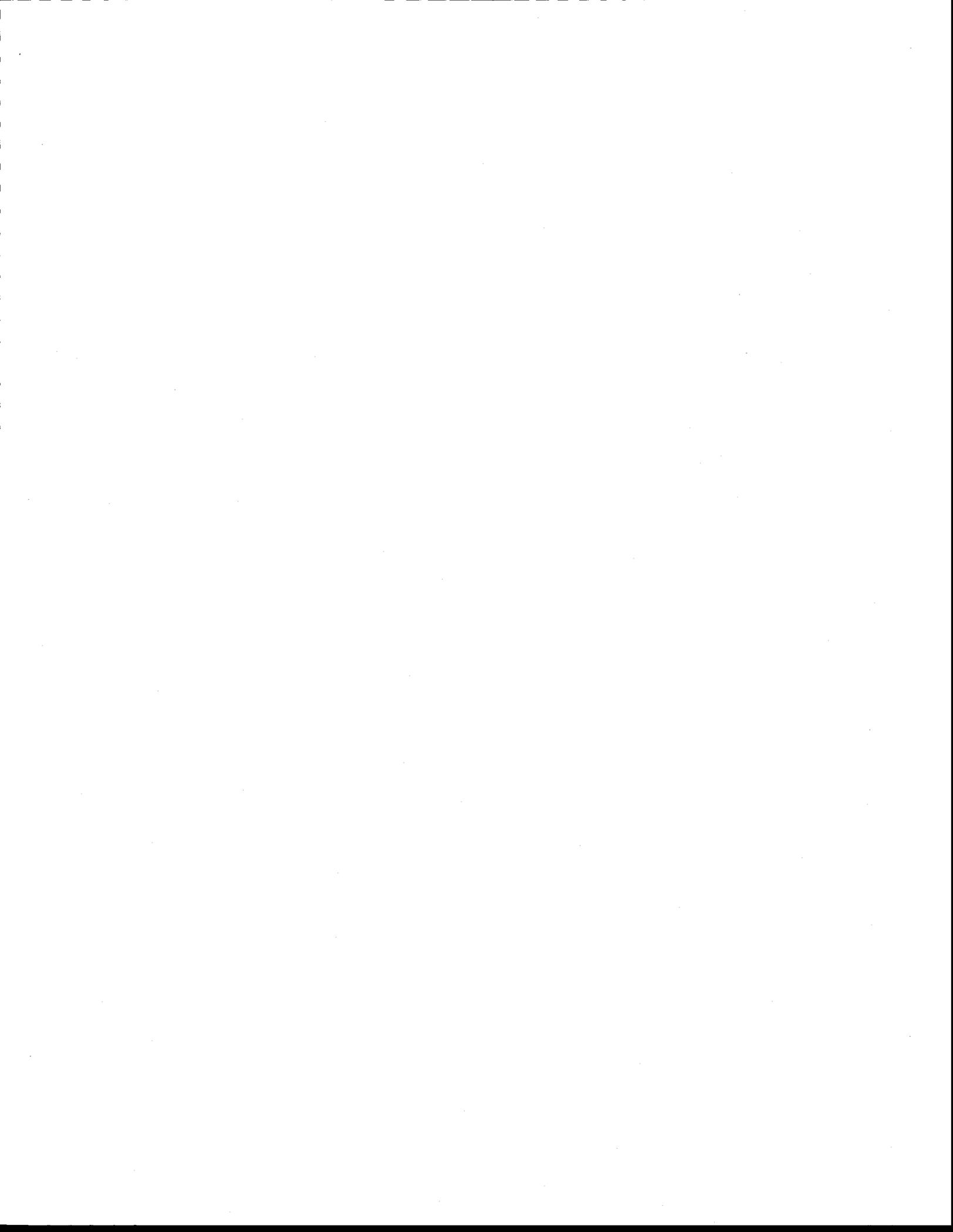
David Crotts, Fiscal Analyst

Ken Melton, Commission Assistant

Linda Millsaps, Fiscal Analyst

Mary Shuping, Research Assistant

Martha Walston, Co-Counsel



## PREFACE

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The North Carolina Tax Policy Commission is established in Part III of Chapter 395 of the 1999 Session Laws. The Commission is comprised of 15 members representing the diverse interests and geographic regions of the State and includes individuals with expertise in tax policy, tax administration, and professional tax practice. The members are appointed by the President Pro Tempore of the Senate, the Speaker of the House, and the Governor.

The Commission's primary mission is to establish the principles of taxation upon which a sound State and local tax structure should be built for the 21<sup>st</sup> century. The Commission is to examine the current State and local tax structure to determine if it reflects these principles. The Commission is to recommend changes in the State and local tax structure that are necessary to achieve a clear and consistent tax policy that reflects these benchmark tax principles.

The Commission is authorized to issue an interim report to the 2000 Regular Session of the 1999 General Assembly. The Commission must submit a final report no later than March 1, 2001, to the General Assembly, the Governor, and the citizens of the State.

A copy of the Commission's authorizing legislation is found in **EXHIBIT A**.



## COMMISSION PROCEEDINGS

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The Commission met twice before the convening of the 2000 Regular Session of the General Assembly: March 15, 2000, and April 13, 2000. The Commission discussed its role in developing a clear and consistent tax policy for the 21<sup>st</sup> century. To make decisions about the future tax policy of the State, the Commission felt it needed to fully understand how the current State and local tax policy had evolved over the years. The Commission began its work with an excellent presentation from Don Liner, a faculty member of the Institute of Government. He gave the Commission a detailed history of tax policy in this State since 1900. A summation of his remarks, prepared by the Commission's clerk, is found in **EXHIBIT B**.

The Commission also examined all of the following:

- The current State and local revenue sources.
- A comparison of North Carolina's revenue structure to that of other states.
- The fairness of the State's tax structure.
- Many of the current tax preferences.
- Legislative and judicial decisions that have shaped tax policy over the last decade.

### Sources of State & Local Revenue

The Commission reviewed all of the following sources of State revenue:

- Individual income tax
- Corporate income tax
- Insurance premium tax
- Alcoholic beverage tax
- Realty transfer tax
- Highway Fund
- Sales and use tax
- Franchise tax
- Gift tax
- Cigarette and tobacco products tax
- Inheritance (estate) tax
- Highway Trust Fund

The Commission noted that the personal income tax has been a leading source of revenue for the State over the past 60 years. Additional information on these State revenue sources is found in **EXHIBIT C**.

In addition to sources of State revenue, the Commission examined the following sources of county and municipal revenues:

**Local Taxes and Fees**

- Property tax
- Occupancy tax
- Impact fees
- Sales tax
- Meals tax
- Other fees and services

**State Aid to Local Units of Government**

- Tax sharing
- Reimbursements

Additional information on these local sources of revenue is found in **EXHIBIT D**.

**North Carolina's Tax Structure as Compared to Other States**

In comparing North Carolina's revenue structure to that of other states, the Commission reviewed the National Conference of State Legislatures' revenue standards and then compared various taxes in North Carolina with similar taxes in other states. Additional information is found in **EXHIBIT E**.

In addition to comparing North Carolina's tax structure to other states, the Commission considered the fairness of the State's current tax structure. Mr. Dan Gerlach, Director of the North Carolina Budget and Tax Center, presented information on what constitutes a good tax system; the characteristics of North Carolina's tax code; tax equity issues; and issues facing the Tax Policy Commission. Additional information on Mr. Gerlach's presentation is found in **EXHIBIT F**.

**Transportation Funding**

The Commission reviewed the funding of the State's transportation system and related concerns. Specifically, the Commission looked at the funding sources for the Department of Transportation, differences between the Highway Fund and the Highway Trust Fund and revenue growth in each fund, and the Highway Trust Fund allocation formula. The Commission also reviewed concerns related to highway funding, including

delays in construction, estimated costs of urban loops, and public transportation. Additional information on transportation funding is found in **EXHIBIT G**.

### **Legislative Actions and Judicial Decisions Shaping State Tax Policy**

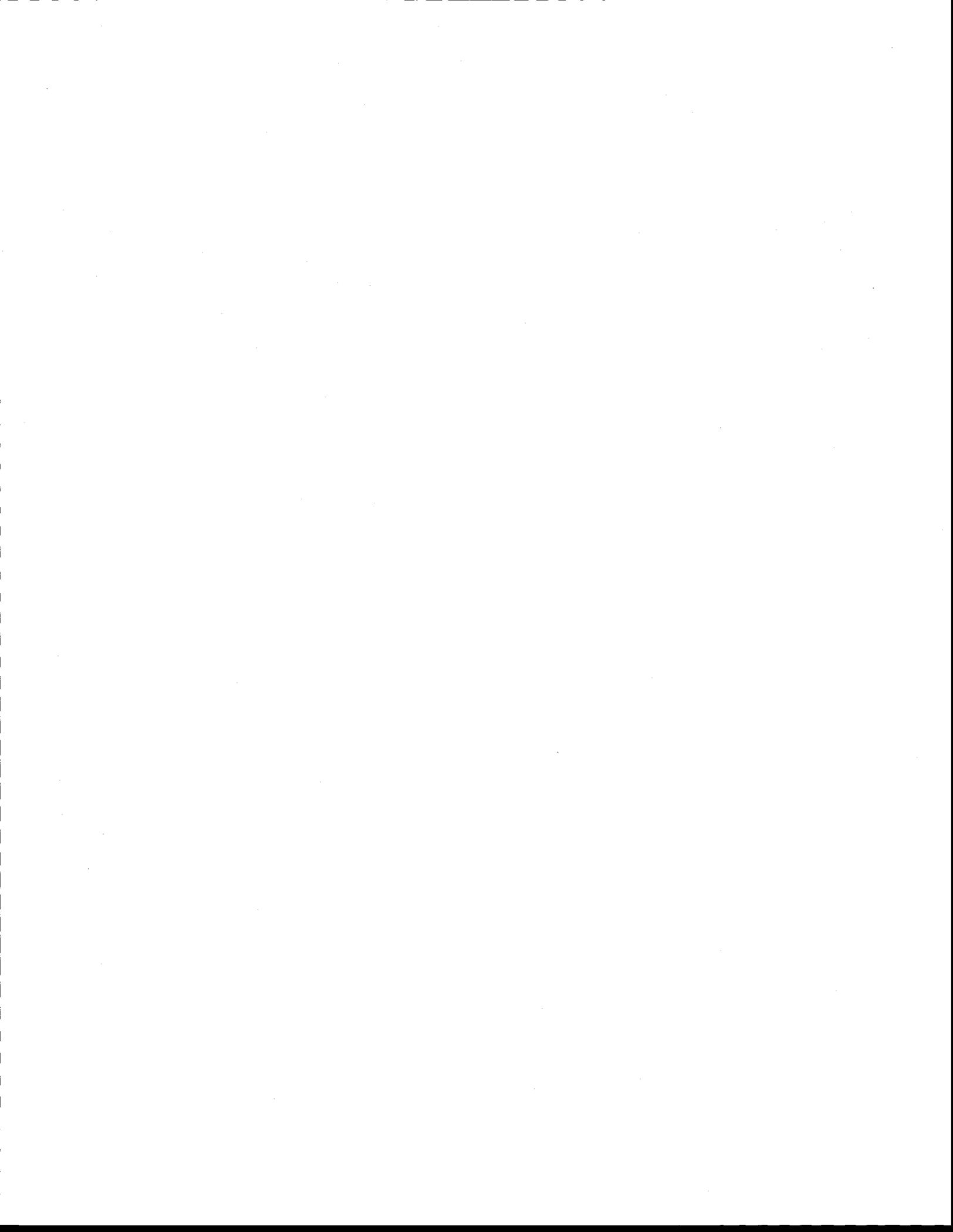
The Commission examined various legislative actions that have shaped the State's tax policy. The Commission looked at actions taken by the General Assembly from 1979 through 1999. The Commission also reviewed the various tax expenditures currently in place, including the fiscal impact on the General Fund.

The Commission also reviewed various court decisions impacting State tax policy. The Commission examined decisions relating to the taxation of business income, fines and forfeitures, economic and tax incentives, taxation of government retirees, the intangibles tax, and school funding.

Additional information on legislative actions and judicial decisions pertaining to State tax policy is found in **EXHIBIT H**.

### **Electronic Commerce Issues**

Lastly, the Commission began discussing issues related to electronic commerce and the impact of remote purchases on the State's sales and use tax base. Sabra Faires, Assistant Secretary for Tax Administration, Department of Revenue, and Commission member, presented information on North Carolina's use tax, and various state and national initiatives regarding collection of taxes on remote purchases. Additional information on electronic commerce issues and initiatives is found in **EXHIBIT I**.



## COMMISSION RECOMMENDATIONS

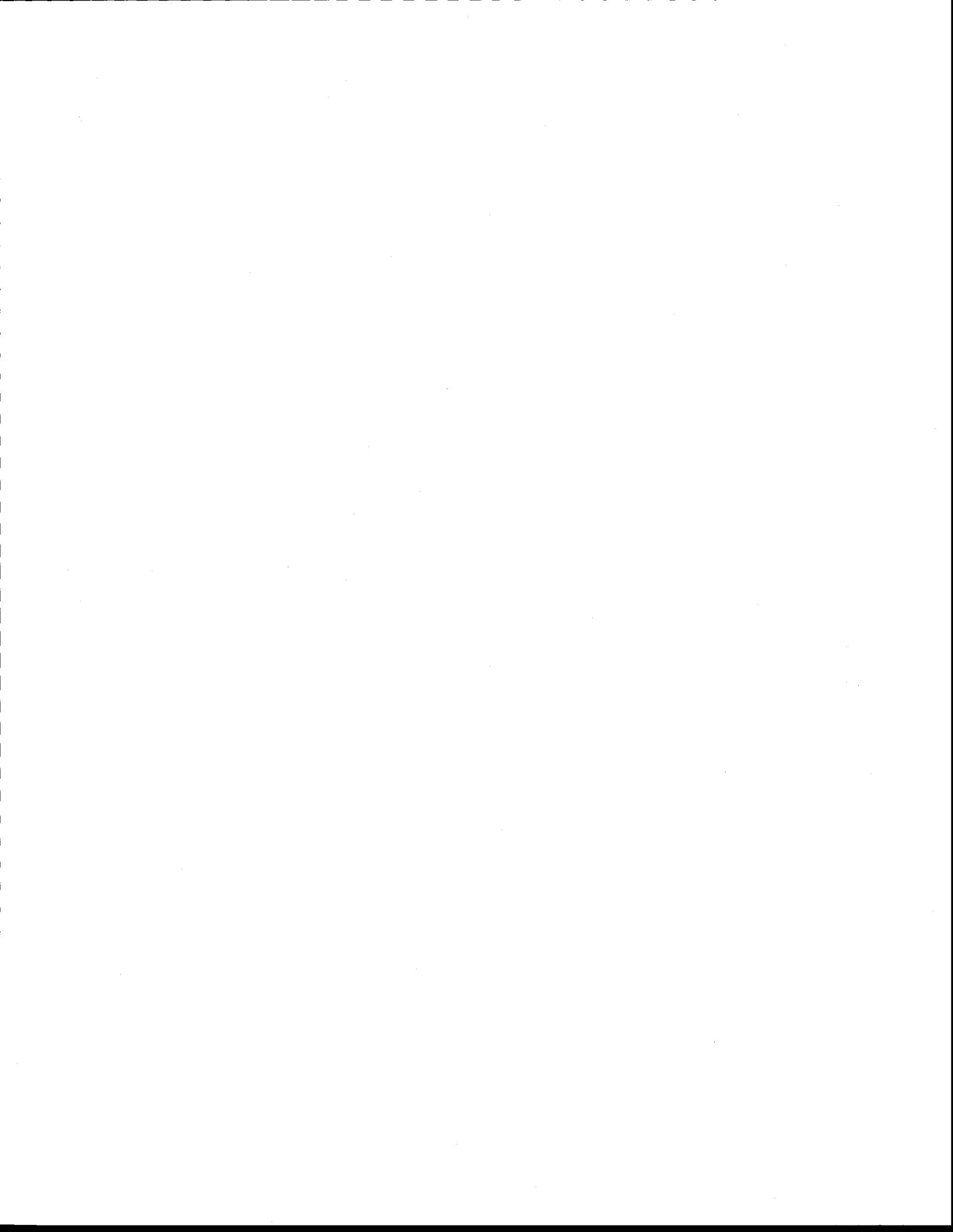
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### *Recommendation #1* *Hiring of Outside Consultant*

Section 3.10 of SL 99-395 authorizes the Commission to employ outside consultants, after consultation with the Legislative Services Commission and within funds available to the Tax Policy Commission. At its April 16, 2000, meeting, the Commission noted the possible need to hire an outside consultant. The Commission voted to grant the Co-Chairs the authority to hire an outside consultant if needed.

### *Recommendation #2* *Increase Commission Membership*

At its April 16, 2000, meeting, the Commission found the need for additional legislative members. The Commission voted to recommend legislation to the 2000 Session of the General Assembly that would authorize both the President Pro Tempore of the Senate and the Speaker of the House of Representatives to appoint an additional legislator to the Commission. The **LEGISLATIVE PROPOSAL** and an explanation begin on the next page.



GENERAL ASSEMBLY OF NORTH CAROLINA

SESSION 1999

S/H

D

00-SCZ-001(4/12)

(THIS IS A DRAFT AND IS NOT READY FOR INTRODUCTION)

Short Title: Increase Tax Policy Commission Membership. (Public)

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Sponsors: Tax Policy Commission.

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Referred to:

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1                                   A BILL TO BE ENTITLED  
2 AN ACT TO INCREASE THE LEGISLATIVE MEMBERSHIP OF THE NORTH  
3 CAROLINA TAX POLICY COMMISSION.  
4 The General Assembly of North Carolina enacts:  
5           Section 1.    Section 3.2 of S.L. 1999-395 reads as  
6 rewritten:  
7           "Section 3.2.   Membership. -- The Commission shall  
8 consist of ~~15~~ 17 members who shall represent, insofar as  
9 practicable, the diverse interests and geographic regions of the  
10 State and shall include individuals with expertise in tax policy,  
11 tax administration, and professional tax practice.  
12           The Speaker of the House of Representatives shall  
13 appoint ~~five~~ six members, as follows: ~~two~~ three members of the  
14 General Assembly, one individual nominated by the North Carolina  
15 League of Municipalities, one individual who represents business  
16 taxpayers, and one public member.  
17           The President Pro Tempore of the Senate shall appoint  
18 ~~five~~ six members, as follows: ~~two~~ three members of the General  
19 Assembly, one individual nominated by the North Carolina

1 Association of County Commissioners, one individual who  
2 represents nonbusiness taxpayers, and one public member.

3 The Governor shall appoint five members, as follows: one  
4 individual who represents tax practitioners, one individual who  
5 represents nonprofit, charitable organizations, one individual  
6 who has demonstrated leadership and expertise in tax policy, one  
7 individual who represents senior citizens and one individual who  
8 represents small business taxpayers.

9 Appointments to the Commission shall be made no later  
10 than August 31, ~~1999~~ 2000. Vacancies shall be filled by the  
11 original appointing authority."

12 Section 2. This act is effective when it becomes law.



# LEGISLATIVE PROPOSAL: Increase Tax Policy Commission Membership

## BILL ANALYSIS

**Committee:** RECOMMENDED BY:  
Tax Policy Commission

**Introduced by:**  
**Summary by:** Mary Shuping  
Research Assistant

**Date:** April 16, 2000

**Version:** DRAFT: OO-SCZ-001(4/12)

**SUMMARY:** *This bill would add two (2) additional legislators to the membership of the Tax Policy Commission.*

**CURRENT LAW:** Currently, Section 3.2 of SL 99-395 establishes the membership of the Tax Policy Commission as follows:

- **Speaker of the House** appoints 5 members – 2 members of the General Assembly; 1 individual nominated by the NC League of Municipalities; 1 individual who represents business taxpayers; and 1 public member.
- **President Pro Tempore of the Senate** appoints 5 members – 2 members of the General Assembly; 1 individual nominated by the NC Association of County Commissioners; 1 individual who represents nonbusiness taxpayers; and 1 public member.
- **Governor** appoints 5 members – 1 individual who represents tax practitioners; 1 individual who represents nonprofit, charitable organizations; 1 individual who has demonstrated leadership and expertise in tax organizations; 1 individual who represents senior citizens; and 1 individual who represents small business taxpayers.

**BILL ANALYSIS:** This bill would increase the number of legislators on the Commission by providing that the President Pro Tempore and the Speaker appoint 3 members of the General Assembly.



# **EXHIBIT A**

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## **Authorizing Legislation**



**GENERAL ASSEMBLY OF NORTH CAROLINA  
SESSION 1999**

**SESSION LAW 1999-395  
HOUSE BILL 163**

AN ACT TO AUTHORIZE STUDIES BY THE LEGISLATIVE RESEARCH  
COMMISSION, TO CREATE VARIOUS STUDY COMMISSIONS, TO DIRECT  
STATE AGENCIES AND LEGISLATIVE OVERSIGHT COMMITTEES AND  
COMMISSIONS TO STUDY SPECIFIED ISSUES, AND TO AMEND OTHER  
LAWS.

The General Assembly of North Carolina enacts:

.....

**PART III.-----NORTH CAROLINA TAX POLICY COMMISSION**

Section 3.1. Commission Established. -- There is established a North Carolina Tax Policy Commission.

Section 3.2. Membership. -- The Commission shall consist of 15 members who shall represent, insofar as practicable, the diverse interests and geographic regions of the State and shall include individuals with expertise in tax policy, tax administration, and professional tax practice.

The Speaker of the House of Representatives shall appoint five members, as follows: two members of the General Assembly, one individual nominated by the North Carolina League of Municipalities, one individual who represents business taxpayers, and one public member.

The President Pro Tempore of the Senate shall appoint five members, as follows: two members of the General Assembly, one individual nominated by the North Carolina Association of County Commissioners, one individual who represents nonbusiness taxpayers, and one public member.

The Governor shall appoint five members, as follows: one individual who represents tax practitioners, one individual who represents nonprofit, charitable organizations, one individual who has demonstrated leadership and expertise in tax policy, one individual who represents senior citizens and one individual who represents small business taxpayers.

Appointments to the Commission shall be made no later than August 31, 1999. Vacancies shall be filled by the original appointing authority.

Section 3.3. Mission. -- The mission of the Commission is to study, examine, and, if necessary, design a realignment of the State and local tax structure in accordance with a clear, consistent tax policy. This mission requires:

- (1) Establishing the principles of taxation upon which a sound State and local tax structure should be built for the 21st century.

(2) Examining the current State and local tax structure to determine if it reflects these principles.

(3) Recommending changes in the State and local tax structure to the extent it does, and does not, reflect these benchmark tax principles.

(4) Recommending principles and practices to simplify and consolidate existing taxes to provide uniformity; to ease the administrative burden on the taxpayer; to maximize taxpayers' use of electronic tax payment and reporting methods; and to reduce the costs of collecting and administering taxes.

**Section 3.4. Duties. -- The Commission shall:**

(1) Evaluate the current State and local tax base in terms of:

- a. Responsiveness of each base to the changing and emerging economies (e.g., from farming and manufacturing to services, commerce, such as Internet sales, and technology).
- b. Rates compared to other states.
- c. Cost of collecting each tax.
- d. Tax burden imposed on individuals and businesses in the State.
- e. Principles of taxation reflected in the tax.

(2) Examine all current tax preferences, such as lower rates, exemptions, exclusions, and refunds, to determine their public policy purpose; examine the narrowing of the tax base that is a product of these preferences; and evaluate the resulting impact on taxpayers not eligible for these preferences.

(3) Review tax changes made in the last 10 years to determine their impact on the State compared to their projected impact, and to assess any economic or demographic conditions on the horizon that may alter their impact.

(4) Examine the impact of changing intergovernmental (federal-State-local) relationships upon funding among levels of government and the resulting impact upon tax policy; and examine how the State, counties, and cities will share a reduced federal funding role, when, in 2003, the Balanced Budget Act takes full effect and federal domestic spending is fully capped.

(5) Examine the impact of changing interlocal, (city/county) service systems and the resulting effect on local tax policy; and examine how area-wide services, such as fire suppression, water-sewer, and recreation, should be financed and allocated.

**Section 3.5. Report. --** The Commission shall submit a final report of its findings and recommendations by March 1, 2001, to the General Assembly, the Governor, and the citizens of the State. The Commission may also make an interim report, including recommended legislation, to the 2000 Regular Session of the 1999 General Assembly, and to the Governor and the citizens of the State. The report shall include draft legislation to implement its recommendations along with an analysis of the fiscal impact of each recommendation. The Commission shall terminate upon filing its final report.

**Section 3.6. Expenses of Members. --** Members of the Commission shall receive per diem, subsistence, and travel allowances in accordance with G.S. 120-3.1, 138-5, or 138-6, as appropriate.

Section 3.7. Cochairs; Meetings. -- Cochairs of the Commission shall be designated by the Speaker of the House of Representatives and the President Pro Tempore of the Senate from among their respective appointees. The Commission shall meet upon the call of the chairs. A majority of the members of the Commission shall constitute a quorum.

The Commission may meet during a regular or special session of the General Assembly, subject to approval of the Speaker of the House of Representatives and the President Pro Tempore of the Senate. The Legislative Services Commission shall grant adequate meeting space to the Commission in the State Legislative Building or the Legislative Office Building.

Section 3.8. Subcommittees. -- The Commission may appoint subcommittees of its members and other knowledgeable persons or experts to assist it. It may also appoint a Technical Advisory Board, if deemed desirable by its members to have an ongoing body of technical experts.

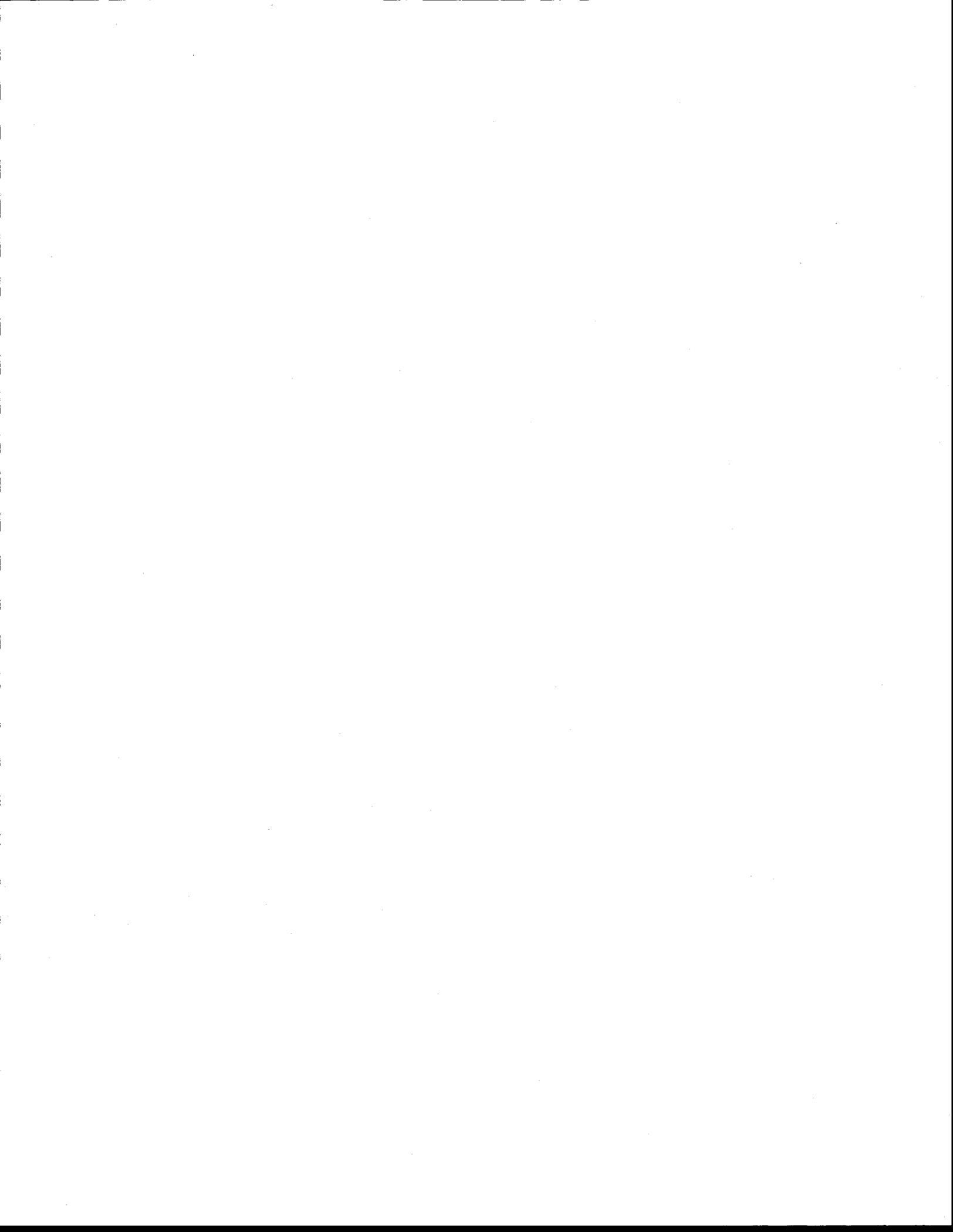
Section 3.9. Citizen Participation. -- The Commission shall establish a process of citizen education and participation that assures the citizens of North Carolina of the opportunity to be informed of and contribute to the work of the Commission.

Section 3.10. Staff. -- Within funds available, the Commission, after consultation with the Legislative Services Commission, shall employ a full-time Executive Director who shall report to the Commission and serve at its pleasure. The Executive Director shall be the Chief Executive Officer and may employ additional employees and contract for services, subject to approval of the Commission. Additional staff may be provided to the Commission by the Legislative Services Office.

Section 3.11. Powers. -- The Commission, while in the discharge of official duties, may exercise all the powers provided under the provisions of G.S. 120-19 through G.S. 120-19.4. The Commission may contract for consultant services as provided by G.S. 120-32.02, including revenue forecasting and estimating services from the Tax Research Division of the Department of Revenue.

Section 3.12. Cooperation by Government Agencies. -- The Commission may call upon any department, agency, institution, or officer of the State or any political subdivision of the State for facilities, data, or other assistance.

Section 3.13. Funding. -- The Legislative Services Commission shall allocate from the General Assembly reserves up to five hundred thousand dollars (\$500,000) for the expenses of the Commission. The Commission may apply for, receive, and accept grants of non-State funds, or other contributions as appropriate to assist in the performance of its duties.

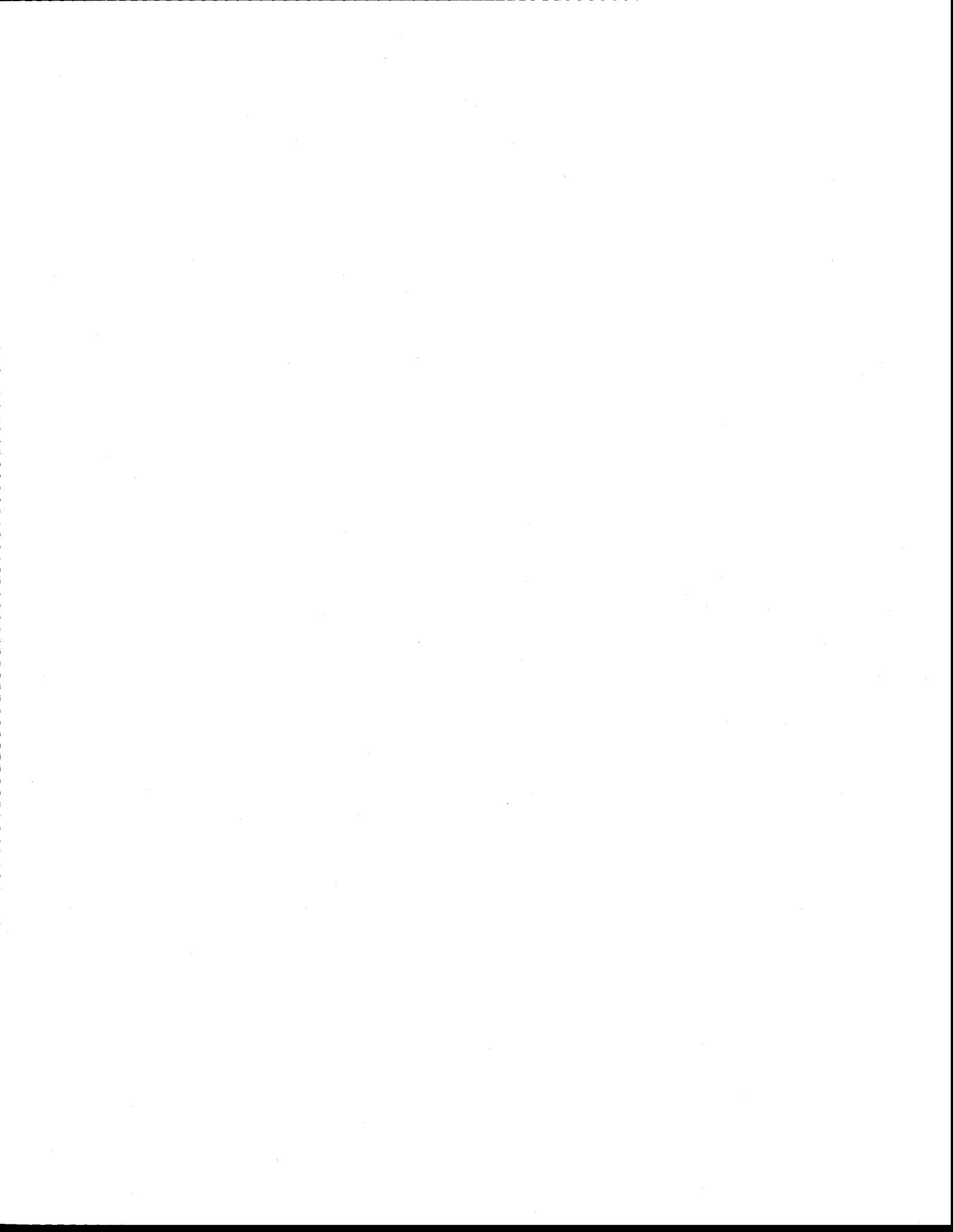


# **EXHIBIT B**

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## **SUMMATION OF REMARKS BY DON LINER**

**Prepared by Ken Melton, Committee Clerk**



## History of State and Local Tax Policy in North Carolina

Summary of Remarks by Dr. Charles D. Liner,  
Institute of Government, University of North Carolina  
March 15, 2000

### **INTRODUCTION**

The story of how North Carolina changed its tax system during the twentieth century is one of the most interesting and important stories about North Carolina. It involves inspiring stories of personal leadership and influence and involves bold measures taken by the General Assembly. It involves developments that have created untold benefits for the people of North Carolina. If you're interested in tax policy and if you're interested in North Carolina's system of governance, you need to know this story.

For example, how is it that North Carolina, a very poor, rural state in 1900, came to be the leader among states in modernizing its system of government and taxation? How is it that a state government like North Carolina's, which had virtually no tax system of its own in 1900, came to have a tax structure today that collects nearly three quarters of the total of tax revenue collected by state and local governments in North Carolina? How is it that the property tax, which accounted for well over 90 percent of all of the tax revenue in North Carolina in 1900, now accounts for about 12 percent of general revenues? These are great changes that have occurred in North Carolina and it is very important to understand why they happened.

I would also argue that the issues that we face today are basically the issues that North Carolina faced in 1900. Those issues are, first, how to provide an effective and uniform system of government services across the state when the ability of the local units to finance those services varies greatly? A problem we still have today is that, with all of the economic progress in North Carolina in the last century, the disparity in per capita income is still two to one between our richest and poorest counties, and the property tax base disparities are even greater than that. The second issue, which is the most fundamental issue in tax policy, is how to devise a system of taxes that distributes the cost of providing government services equitably among the people. That is what our constitution requires: that we use the power of taxation in a "just and equitable manner."

If for no other reason, we need to study our tax history because our tax structure is now almost 70 years old.

## **THE TAX STRUCTURE IN 1900**

I am going to begin in the year 1900. I choose that year not because it was an even year or because it was the beginning of a century, but because 1900 was a great watershed year in the history of North Carolina. At that time North Carolina was a poor, almost destitute, state. North Carolina had been brought to its knees economically, politically, and socially by the Civil War and Reconstruction. It had been through a long period of political and racial strife. It had been bypassed by the Industrial Revolution. The state was just beginning to industrialize. According to the population census for that year, 90.1% of the people were rural; less than 18% of the people lived in incorporated places; 64% of the people worked in agriculture and mining—today that's well less than 5%. The state was beginning to industrialize, but very unevenly. Twelve counties accounted for almost 80% of the value added in manufacturing that year, and just two counties, Forsyth and Durham, accounted for 42%. So there were great disparities, and these disparities were to increase as industrialization continued.

The largest town or city in North Carolina was Charlotte. There was no city whose population exceeded 25,000 (Charlotte was getting close). There were only 6 towns with populations exceeding 10,000 and 12 with populations exceeding 5,000.

This was the state of North Carolina in 1900. What was the state of state government? What services did state government provide? They were very minimal. The only services that the state provided in 1900 involved eight institutions. It provided a central prison to house long-term prisoners; the rest of the prisoners were in county road camps or county jails. It provided a school for the deaf and blind. It supported two orphanages and three mental hospitals: Dorthea Dix Hospital, and the hospitals in Morganton and Goldsboro. Counties had to pay the cost of the patients they sent there. It included one soldier's home. That was the sum total of services provided directly by state government in the year 1900. The state built no highways and had no welfare programs. The public health program in the state mainly involved sanitation inspections of those eight units. The state did support higher education with an appropriation of \$150,000 to support 4 institutions: the University of North Carolina at Chapel-Hill, what was then called the Women's Normal and Industrial College in Greensboro, and two African American institutions called A&M College and A&T College.

One thing that the state did that year was very significant for the future. For the first time since the Civil War, the state government provided financial support to local public schools, by distributing funds from an appropriation of \$100,000.

I'm really not exaggerating when I say that the state did not have a substantial tax system of its own. The biggest source of revenue for the state government in 1900 was the property tax. That year the state collected a total of \$1.6 million in revenue. Of that amount 55% came from the local property tax. That is, the sheriff collected both the county tax and the state tax and remitted the state portion to the Treasurer in Raleigh. The second largest source of revenue was dividends from railroad stock owned by the state. Next to that was franchise taxes on insurance companies, banks, and railroads. In addition there were privilege license taxes called Schedule B taxes—we still call them Schedule B taxes and they are basically the same kind of taxes. The state received a small amount of money from the income tax, which then was a locally administered tax and mainly a tax on honesty, and the state was compelled by the constitution to levy a poll tax of \$1.29 per person.

So the main taxes in North Carolina for both state and local government were the property tax and the poll tax. You know about the poll tax: it is the most regressive form of tax; it is the same for the rich and the poor and therefore the burden is much greater on the poor. The poll tax was used throughout North Carolina's history from colonial days to the late 1960s. The main tax, of course, was the property tax.

## **PROPERTY TAX**

There was no problem with the property tax itself. In fact, the property tax used then was basically the one we've used since. It was originally created in the period between 1835 and 1860 as a means of trying to structure taxation according to the ability to pay principle of tax equity. There was a national movement then to create what was called universal and uniform property taxation. "Universal" meant that all forms of property were taxed. So you taxed not only the land and the improvements but also the inventories of merchants, stocks and bonds owned by the bankers, and the value of pianos and chandeliers and jewelry owned by the rich doctor or lawyer. That was the concept of tax equity that underlay the property tax that existed in 1900. We'll see that that concept stayed intact until the 1980s.

Again, the problem was not with the property tax itself. The basic problem was the problem we still face today: to the extent we rely on local governments and local tax bases to support programs that need to be provided uniformly across the state, we are going to have great inequalities in the provision of those services, and great inequalities in tax burdens. There was an additional problem at that time in that the property tax was very poorly administered. There was no state supervision; much property escaped taxation and most of it was greatly under-assessed.

## **LEADERS IN TAX REFORM**

Now we come to the great changes that began to be made. I mentioned earlier that this is a story of great personal leadership. If I were asked to name the most influential people in North Carolina's history, I would give three names, two of which feature in our story today. The first was Archibald Murphy of Hillsborough, who led a great era of progress in the period of 1835-1860, including the founding of the state's first public school system. The second person is someone you probably never heard of, a woman named Harriett Berry, and she will figure into our story later. The third person is Governor Charles B. Aycock, who was elected governor in 1900. His party, the Democratic Party, imposed a literacy test for voting. I would not like to try to defend that measure, but Governor Aycock defended it as necessary, but said that in return he wanted to ensure that public schools were available to every child in the state. So Governor Aycock began a personal crusade for public schools and single-handedly brought about a ground swell of support and enthusiasm for public schools throughout the state. He crossed the state many times and gave hundreds of speeches encouraging support of the schools. If you walk over to the Education Building you will see a monument that cites his last words, given in yet another speech about the value of the public schools.

Aycock convinced people in communities across the state to tax themselves to improve schools, to build high schools, which were not then generally part of the school system, and to extend the length of the school term. What was really needed, of course, was state action. The 1868 Constitution had required the General Assembly, at its next session, to create a general and uniform system of public schools throughout the state that would operate for a minimum term of four months. The General Assembly actually appropriated \$100,000 for this purpose, but the state was so poor that no money ever came from that source. So all the state could do was to require counties and county commissioners to levy property taxes and poll taxes to support the schools. By 1900, there were 97 counties and 40 of them could not provide a four-month school term even if they levied the maximum property tax rate allowed by law.

The General Assembly had responded by making the first appropriation for public schools since the end of the Civil War. That first appropriation, of \$100,000, was used to distribute funds to all school on a per student basis. In 1901, North Carolina created what I have discovered to be the first major equalizing program of any state in the nation. It appropriated an additional \$100,000, but designated that the additional money would go only to those 40 counties that could not provide the minimum term. North Carolina continued to use this equalizing fund, in various forms, and to expand it until 1931. It is the type of program that most states still rely upon to help local units provide public schools.

Progress in the state was very great. In 1913, the school term was extended to six months. By 1919 the state was paying half of teacher's salaries. By 1930 two-thirds of the schools had an eight-month term. So great progress was made following the leadership of Governor Aycock.

## **HIGHWAY TAXES**

Now to switch our story to Harriett Berry. Harriett Berry was a lobbyist for the North Carolina Good Roads Association, founded in 1902. She was probably the most successful lobbyist in the history of North Carolina. Here's the story: In 1900 automobiles were mainly contraptions that scared horses. There weren't many of them around, but by 1910 there were 10,000 registered in North Carolina, and by 1919 there were 109,000 of them.

In 1901 the state created its first highway commission but did not give it any money. It had only an advisory role, and it lasted only two years. When in 1916 the federal government began giving grants to the states to build highways, the state government had no highway program, so counties had to provide funds to match the federal grants. This is where Harriett Berry came in. She persuaded a person named Cameron Morrison, who was running for governor, to support the building of a "great road system". He bought that line and he ran for governor on that platform. When he became governor, Harriett Berry worked closely with the General Assembly to draft the legislation and get the money needed to build the road system. What was involved? A road system that connected all 100 county seats in North Carolina, all the principal cities, and all the state parks and state institutions. Fifty-five hundred miles of county roads were taken over by the state and paved to what were then modern standards.

How did the state pay for this? With a new gasoline tax enacted in 1921, and by borrowing \$50 million, which was several times the amount of the state budget. Was it successful? It was a roaring success. North Carolina became known as "The Good Roads State." People came from not only other states but from all over the world to see how North Carolina built highways. By 1930, there were 10,000 miles in the state system. But the greatest testimony to its success came in 1949. This was about the time that Governor Kerr Scott was launching another highway program called the farm-to-market road system (which is one reason why North Carolina has one of the best rural road systems in the nation). In 1949, a commission was created to study financing of city streets. The amazing thing was that the Governor and the League of Municipalities recommended to that commission that the state Department of Highways take over responsibility for the 7,000 miles of city streets. That probably would not have been wise, but it serves as testimony as to how successful the state had been in building its road system. (In fact, the state did take over responsibility

for thoroughfares within city boundaries.) Today, Harriet Berry's "great road system" is the largest state-maintained road system in the nation.

### **1921: FROM PROPERTY TAX TO INCOME TAX**

1921 was a critical year in the development of North Carolina's tax system in another way, as well. The North Carolina tax system was basically set in place by the actions taken in 1921, 1931, and 1933. In 1921, the state was still getting most of its revenues from the property tax. It had begun to supervise property tax administration and to try to get improvements in assessments and discovery, but it still relied on the property tax. In 1919, the state required all counties to revalue property. As a result, the tax base increased by a factor of three, which meant that before revaluation much of the property had not been taxed or had been greatly under-assessed. It also demonstrated that the state's use of the property tax gave local governments the incentive to keep property tax assessments low. So the state's use of the property tax was spoiling the property tax itself.

To address this problem, in 1921 the General Assembly adopted a new policy, that the state would no longer rely on the property tax but rather would rely solely on state revenue sources. The property tax would be strictly a local tax. Thus, the state created its own state tax system. First, it enacted a personal income tax--a progressive personal income tax that was very similar to the tax that would remain in use until 1989 and which essentially is the same kind of income tax that we have today. Second, it enacted a corporate income tax. Third, as mentioned above, it enacted a gasoline tax to finance the highway system. These measures put in place the first two key elements--income and gasoline taxes--of North Carolina's current state tax system.

### **1931: FISCAL REVOLUTION**

The next step was taken in 1931 and 1933. During the 1920s, North Carolina continued to experience industrialization and urbanization. There was tremendous pressure on cities and counties to expand services, and one means of financing expanded services was to borrow money. I once calculated that in 1930 North Carolina had the second highest level of per capita debt in the nation after New York, which was a much wealthier state. So when the depression hit, everything went to pieces. North Carolina had more defaults on its debt than any other state in the nation. All across the nation, of course, things were bad--schools were being closed, services were being reduced, salaries were being cut. So when the General Assembly met in 1931 it faced a serious problem--people could not pay their property taxes, and schools and other services were in jeopardy. The General Assembly in that session began what I call the fiscal revolution, something that has never been matched in any other state.

First, the state assumed responsibility for paying the operating expenses of the public schools for a term of six months. Second, the state took over 45,000 miles of county roads. It put counties out of the road business, and abolished about 200 road-building jurisdictions. Third, it took over the prison system. The state accepted responsibility for all prisoners sentenced to 60 days or more (reduced to 30 days or more in 1933). That's why we have such a large prison system--the state took over all of the road camps from the counties. The General Assembly also established the Local Government Commission, which is still in existence and thriving. The purpose of the Local Government Commission was first to help the cities and counties get out of their debt problems and then to supervise the finance of local government's fiscal affairs. North Carolina is one of the few states and the leading state in that kind of endeavor.

How would the state finance these measures? The main proposal was to enact a retail sales tax. If North Carolina had enacted a sales tax, it would have had the first retail sales tax in the nation. There was much controversy over the fairness of the tax, some people labeling it a "poor man's luxury tax." When the bill failed to pass, the General Assembly reverted to a using temporary state property tax and increased the rates on its other taxes.

### **1933: SALES TAX**

By 1933, the economic situation was worse. The General Assembly came back to Raleigh and extended that revolution by accepting responsibility for financing an equal eight-month school term throughout the state. The state was to pay the operating expenses of the school system for an eight-month term. And this time the state enacted the retail sales tax (the previous year Alabama had become the first state to do so). North Carolina thus became one of the first states to have the two major broad-based taxes that are generally considered essential to support modern state services, an income tax and a retail sales tax.

This was North Carolina's fiscal revolution. What it meant was that the major financial responsibilities of counties--schools, roads, and prisons--were, in large part, turned over to the state. Before this revolution, the property tax accounted for two-thirds of the total revenue collected in North Carolina; after the revolution it accounted for only one-third. Today it accounts for even less than that. North Carolina's fiscal revolution literally changed the nature of state and local government. It put in place the current tax system. It was another watershed event.

## **THE TAX SYSTEM SINCE 1933: CENTRALIZATION**

What has happened since that time? Remarkably, although the state has been through a period of tremendous expansion in government services and through periods of great change, the tax system has stayed fairly stable. North Carolina was able to finance a vast expansion in government services with relatively little change in its tax structure. Other states, faced with increasing fiscal pressures over the years, had to enact sales taxes and income taxes in the 1960s, 1970s, and 1980s that North Carolina enacted much earlier.

So North Carolina was well in the lead. But these steps were just the beginning of centralization of financial responsibility. Centralization has continued. For example, in the 1930s, there were tremendous gains in the provision of social services and public health programs, mainly because of federal initiatives. It was the state government, as well as the federal government, that provided most of the financing for the new services. In the 1960s, state government took over complete responsibility for the judicial system of North Carolina. Before that we had a county-based system that was very uneven across the state. When the state wanted to create the community college system in the 1960s, it was the state government that took the lead and provided most of the funds. So this centralization has continued on until today. North Carolina, as I said earlier, collects almost three-quarters of its total taxes at the state level. Another thing to realize is that for every dollar appropriated by the General Assembly, about 72 percent goes to finance services that are provided by city or county governments.

So this is the state and local system that has resulted from historical developments. We can no longer separate the tax system of the state from the tax system of the counties and cities. We can no longer even distinguish the responsibilities for providing different services. Today we have a system of shared responsibility for public services.

## **CHANGES IN REVENUE STRUCTURE**

I have said that state taxes have remained basically stable, but the structure of revenues has not. In the 1930s, the income tax was mainly a tax on the wealthy. It accounted for only about 5% of general fund revenues. Over time, particularly during World War II and afterwards, when people's incomes increased their incomes rose above the basic level of exemptions and fell subject to the higher tax brackets of the personal income tax. As a result, income tax revenues increased much more than those of any other source, until today the income tax accounts for over one-half of General Fund revenues. The personal income tax -- not the property tax nor the retail sales tax -- the personal income

tax is the largest source of tax revenue in North Carolina. It is also the key to tax equity because if a state does not have a progressive personal income tax there is no way to offset the regressiveness of the retail sales tax and other taxes.

On the other hand, corporate income tax revenue, which accounted for about half of general fund revenue in the 1930s, has constantly diminished relative to the total until it now accounts for about 6 percent of total general fund tax revenues. That has happened not because we have cut the rates on the corporate income tax but because of the great growth of the personal income tax, and because retail sales taxes have been increased.

The two main changes that have occurred since 1933 involve the retail sales tax and the property tax. I think it's important to look at what has happened to the sales tax. North Carolina had a 3% state sales tax in 1933, and that rate stayed the same until 1991, when it was raised to 4% during a budget crisis. Thus the state rate has been increased only one time. The state did add food sales to the sales tax base in 1961 to support education programs, but now food sales are exempt from the state portion of the tax (but not the local portion). In 1967, Charlotte-Mecklenburg received authority from the General Assembly to levy a one-cent local sales tax. This was accepted as a great idea by local government officials, who pressed for their own sales tax. So in 1971, the General Assembly authorized the remaining counties to have a one-cent local sales tax. This tax was intended to be an additional source of general revenue for local government, so the money that was collected was sent back to the county where it was collected. Thus, each county got all of the money that was collected in the county, and that money was divided between the county government and its cities.

In 1980, the state faced a different circumstance. About every ten years the public school officials would push for a new state school construction bond issue. There were state bond issues in 1951, 1961, and 1971. In 1981, they pressed forward again. But, if you remember, the interest rates in 1981 were high then, and the General Assembly decided not to borrow money. Instead, in 1983 it authorized an additional one-half cent retail sales tax as a local option sales tax for the purpose of school construction in counties and improvement of water and sewer systems in cities. However, there was a big philosophical change made in the distribution of that tax. Instead of sending the taxes back to where they were collected, revenues were distributed according to the population of the counties. And in 1986 another half-cent tax was authorized on the same basis. So we now have one cent of the local sales tax distributed according to where it is collected and another cent distributed according to county population. Many of the poorer units get twice as much money from the second one-cent tax rate as they do from the first one-cent rate, and of course

larger cities and counties get less. Basically this is a revenue sharing scheme--it would be no different if the state increased its own retail sales tax by one-cent and gave the money back to the counties and cities according to county population. So the sales tax is really not a local tax. It can be viewed as either a state-shared tax or a state revenue sharing program.

Thus, the biggest change in use of taxes since the 1930s is the increase in the use of retail sales taxes--we have gone from a tax rate of 3 percent in 1933 to 6 percent today. That is a doubling of the rate of the retail sales tax since 1971.

The other major change involves the property tax. There have been more changes made to the property tax in the last twenty years than we've probably ever had before. Remember that concept of universal property taxation—that all forms of property should be taxed? In 1984 or 1985, we repealed the property tax on household personal property, such as pianos and chandeliers and jewelry. It was a farce at that time anyway because taxpayers usually accepted the option of claiming the value of their personal property as equal to 10 percent of the value of their home. Then in 1987 the General Assembly began repealing the property tax on inventories of manufacturers, retailers, and wholesalers. The state also repealed part of the intangibles tax. Of course you know what happened in 1995 after the court case: the state repealed the rest of the intangibles tax. So we have whittled away at the concept of universal property taxation.

This has produced an odd situation. We have repealed certain taxes or parts of the tax system, yet counties and cities are still getting revenues from those taxes. How? Because the state has reimbursed the cities and counties for their losses caused by repeal of these parts of their tax base. They lost the growth in revenue from these sources, but they're still getting revenue through annual reimbursements to counties and cities, calculated based on the amount of taxes they were collecting on the repealed portions of their tax bases at the time of the repeals. As a result, we have what amounts to a state revenue sharing scheme amounting to close to a third of a billion dollars a year.

### **IS OUR TAX SYSTEM FAIR?**

What North Carolina has done is to centralize the responsibility for financing government services, so that now the major statewide public services are not dependent primarily on local taxation. That means they are not subject to the great disparities in ability to pay of people in different parts of the state. We finance those services through statewide taxes that are largely based on the ability to pay and from a progressive state tax system. The basic question one must ask is, do we have a fair tax system? Because that is what tax policy is

primarily about. How do we distribute the cost of government services equitably among the people?

The key to that issue is the personal income tax. The personal income tax is not only our largest source of revenue and the one we count on to grow over time, but more fundamentally it is the tax that is key to tax equity. We have seen great expansion in quality and level of services in North Carolina. We have a very effective local government system; it is probably much more effective than those in many other states because it is based on a strong county system of government and a fairly simple structure of county and city government organization.

It is very important to understand the different roles of local governments in North Carolina. In North Carolina, the county's basic role is to serve as an agent of the state government in providing services that are needed by all of the people of the state. So counties are responsible for public schools, public health, and social services. In addition, they can provide other services that their people want, like recreation programs, libraries, and so forth. In North Carolina's system, cities play a different role. Their purpose is to provide an additional level of services to those people who live in urban areas. The system is not as simple as it was in 1900, but basically the same structure prevails.

## **LOOKING TO THE FUTURE**

What are the basic challenges facing North Carolina? What are the basic challenges this commission faces? What are the lessons that we can learn from history? The main question is how do we adapt our system to changing circumstances. That was the challenge in 1900 with the advent of the automobile and increased industrialization and urbanization. North Carolina more than any other state succeeded in making necessary changes to its 19th century system of government. Today we face similar challenges due to technology, but the basic issues are the same. How do we provide government services uniformly across the state when the parts of the state vary so greatly in economic development and ability to pay for services?

The key to any tax policy issue involves the question; is it fair? And for this you must concentrate on the few key tax sources because they bring in most of the money, create the largest burden for taxpayers, and are the ones that most affect people directly. So the first priority must be attention to the income tax. In 1989, under the rationale that we should simplify taxes, North Carolina abolished the personal income tax that was created in 1921 and adopted the federal base as the base for the state tax. This had some good effects. For example, the exemptions had not been increased much since 1921. Adopting the federal base meant that we increased the level of exemptions to \$13,000 or

\$14,000 for a family of four. North Carolina also changed the rate structure, which was graduated from 3% to 7% before 1989, to two rates: 6% and 7%. However, with the budget crisis in 1991, we added a third rate of 7¾ percent (for married couples with income above \$100,000, for example). The critical thing now, of course, is that we are now tied to the federal Internal Revenue Code. North Carolina's constitution says that the power of taxation cannot be surrendered, suspended, or contracted away. So tying the state income tax to the federal tax code does not relieve the General Assembly of the responsibility for ensuring that the income tax is fair. But it presents problems, in that we in effect have either to accept what the federal government does to its income tax base, or to make changes and adjustments later. The income tax is still our most important tax.

Many of the issues that you will face involve retail sales taxes. Two issues are prominent here. First is the taxation of services. The sales tax is a tax on sales of tangible personal property. It does not automatically include taxation of services. If you want services to be included, you have to make special efforts to do that. Now we are shifting more and more away from the purchases of goods to the purchases of services. So if we do not tax services we are leaving out one of the great growing sectors of our economy. There are a lot of pitfalls in this area. Florida tried to enact a tax on services, including newspaper ads and legal services, a few years ago, and quickly had to back down. The trouble is that a lot of the services that people talk about are not final, or "retail" services. Like legal fees for businesses and newspaper ads, they are part of the process of producing retail products, not retail products themselves. Another problem is that many services are medical services, and it often turns out to be politically difficult to tax those services.

The other subject you will deal with here is the question of catalog sales and Internet sales. I don't want to get into the use tax issue, because of course you will hear a lot about it since it is an area of great contention. Last year the General Assembly took a step toward collecting the use tax on out-of-state sales by adding a line on the personal income tax form. The disadvantage of the approach of using the income tax to collect the use tax is that if it can't be enforced, it becomes a tax on honesty. This is not the final solution; I suspect the final solution will involve some kind of state cooperation or third party collection system.

I would like to suggest that you give special attention to the property tax. There is a lot of confusion about the property tax because there is so much political resistance at the local level to increasing property tax rates. Don't confuse that unpopularity or resistance with the notion that this is a bad tax. Keep your mind open about that. Because the property tax is the only tax we have that can be administered locally, can be used flexibly, and can maintain

accountability in local government. So the property tax is still a main, and key, tax in our system of government.

One of the major problems today is that the resistance to increase property tax rates is leading cities and counties to ask for additional sources of revenue—they call them "alternative revenue sources." The problem here is that many of the taxes that they are talking about may not be as fair as the property tax. I particularly point to the increasing use of the flat taxes, such as availability charges for waste disposal, impact fees, flat storm-water charges, and flat motor vehicle taxes. Although these taxes are usually called fees or charges, they are in fact taxes because they have no relationship to the benefits received from public services, and they are much like the highly regressive poll taxes that were used before they were declared unconstitutional in the 1960s. So, the property tax is one key aspect of tax equity and tax change in North Carolina, and it is one that you cannot ignore.

The other area that is difficult is business taxation. We have very simple principles of tax equity--the benefits and ability to pay principles-- that help us to judge what is a fair tax for individuals. But when it comes to taxing businesses, we have no such principles that are directly applicable. It would be fair if businesses paid their share of the cost of the services they benefit from. Then those taxes would be either passed on to their customers, in North Carolina and elsewhere, or absorbed by the owners who profit from the business. But what is the share that should be borne by business?

One problem that you will run in to is that the states are so competitive regarding taxes that economic development becomes a consideration in taxing businesses. This is one factor that has changed greatly in recent years. In 1985, North Carolina had virtually no tax incentives for economic development. We were astonished when Tennessee gave an incentive package for the Saturn automobile plant that amounted to \$26,000 per employee. We were shocked when South Carolina gave a package for a BMW plant that was equal to about \$70,000 per employee. We were stunned when the Mercedes-Benz plant was stolen away by Alabama, which paid an amount equal to more than \$200,000 per job. Two years ago, North Carolina gave incentives to a Nucor plant that amounted to over \$500,000 per job. This escalation in economic development incentives is happening throughout the nation. The problem from the standpoint of tax policy is that these deals are made by the executive branch, and then come to the General Assembly, which almost has to go along with them. This is an issue that almost has to be addressed as a matter of long-term tax policy. The way it is happening now is that we are changing our laws every year based on the deals that are made with individual companies.

## CONCLUSION

Finally, I bring you back to the place where we started—how do we provide statewide services, like public education, uniformly and effectively across the state when the ability of local units to finance services varies greatly? One of the great accomplishments of North Carolina in the twentieth century is what it has accomplished in making public school finance a statewide responsibility. In North Carolina the state government provides 89% of the money for the instructional program in the public school system. In most states that are sued for having school finance inequalities, the richer units spend far more than the poorer units. If you look at the five counties that are now suing North Carolina, Cumberland, Halifax, Hoke, Robeson and Vance, three of them have total spending per student greater than that of Wake County. And the other two have total spending equal to 99% or more of that in Wake County. If you look at the top ten spending units in North Carolina, in terms of total spending per student, they include seven of our poorest counties. At the top is Hyde County, followed by Tyrrell, Alleghany, Graham, and Jones. The others are small city units, the Weldon, Chapel Hill, and Asheville city schools units.

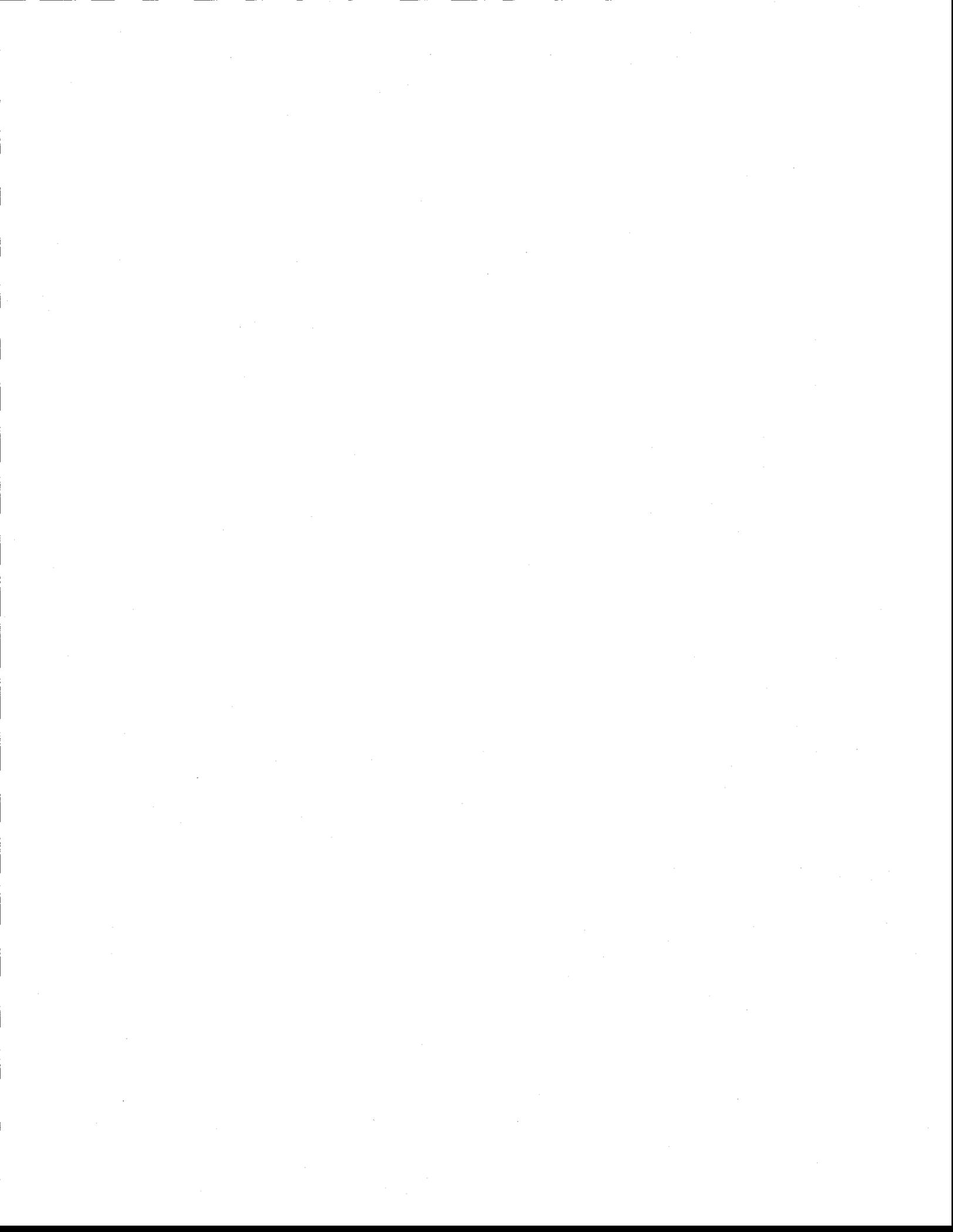
So we have, in fact, equalized spending greatly--there is, in fact, no correlation between total spending per student and per capita income of counties. But this does not mean that we have achieved our equity goals, due in large part to small populations in some counties. For example, Hyde County has 150 high school students. You need a lot of money per student for a full-blown curriculum for a high school in Hyde County, and then many teachers would have few pupils. So one thing we failed to do when we established the basic education program is to understand this fundamental problem in rural counties. The problem is not solely that tax bases are poor in rural counties, but that some counties are too small to provide schools, particularly high schools, efficiently because they have too few students.

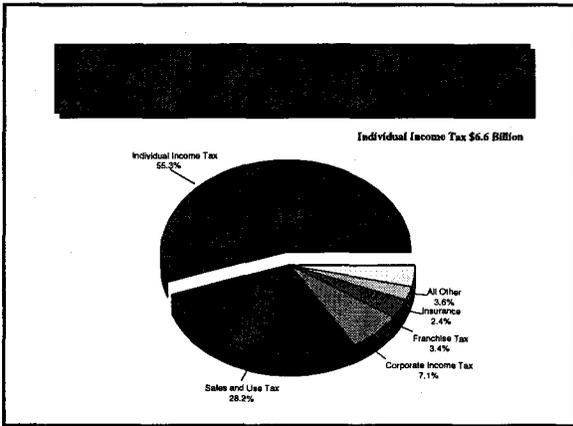
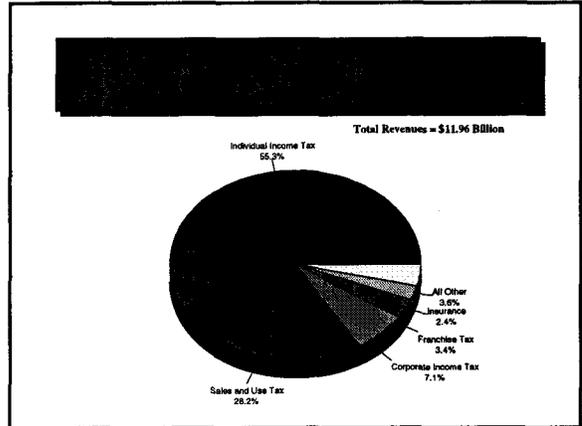
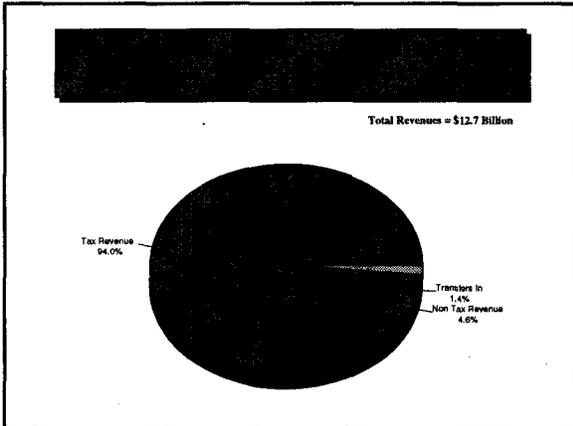
Size of counties generally is another issue that needs to be considered when you talk about the structure of government. We have twenty counties with less than 30,000 population and eight with less than 10,000 population. They can raise the property tax rate considerably and not get much revenue—they are victims of diseconomies of scale. The one thing we have not done in the twentieth century is to change that basic system of county government, which was established long before the twentieth century. I'm not suggesting that we merge small counties or do away with them, but we need to address the problem of how to provide adequate public services, particularly public schools, uniformly and efficiently in those counties.

# **EXHIBIT C**

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## **State Revenue Sources**





- Imposed since 1921
- Basis of tax is federal taxable income (since 1989)
- Reference to Internal Revenue Code updated annually
- No indexing of standard deduction and personal exemption

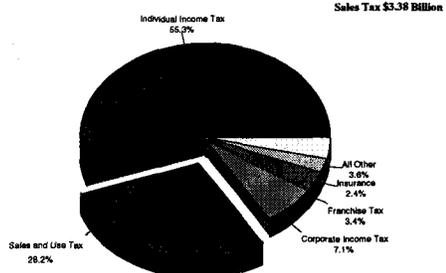
Standard Deduction	State	Federal
Single	\$3,000	\$4,300
Head of Household	4,400	6,350
Married Filing Jointly	5,000	7,200
Married Filing Separately	2,500	3,600
Dependent	500	700
Personal Exemption	2,500	2,750
7.75% of Tax Rate	2,000	2,750

Tax Rates

	6%	7%	7.75%
Single	<\$12,750	<\$60,000	\$60,000>
Head of Household	< 17,000	< 80,000	80,000>
Married Filing Jointly	< 21,250	<100,000	100,000>
Married Filing Separately	< 10,625	< 50,000	50,000>

**Tax Returns**

	<u>Taxable Return</u>	<u>Non Taxable Return</u>	<u>Total</u>
Single	1,041,994	196,016	1,238,010
Married Filing Jointly	1,253,428	119,050	1,372,478
Married Filing Separately	105,162	13,267	118,429
Head of Household	<u>405,566</u>	<u>117,179</u>	<u>522,745</u>
	2,806,150	445,512	3,251,662

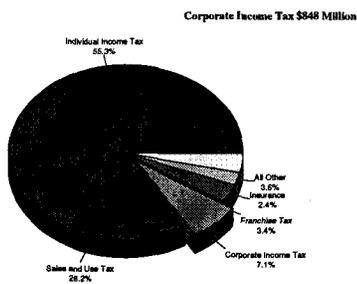


- Imposed since 1933
- Base state rate is 4% (2% local)
- Tax levied on purchases of tangible commodities, room and cottage rentals, and laundry and cleaning services
- Motor vehicles taxed under Highway Use Tax
- Aircraft, boats, railroad cars or locomotives taxed at 3%, \$1,500 maximum



- Manufactured homes taxed at 2%, \$300 maximum
- 1% tax, \$80 cap on machinery and equipment
- 6.5% tax on toll telecommunications
- 2.83% tax on electricity to farmers, manufacturers, and dry cleaners
- Refund tax to nonprofits; schools
- Exemption of food for home consumption

**GENERAL FUND REVENUE MAJOR TAX SOURCES (1998-99)**



**CORPORATE INCOME TAX**

- Imposed since 1921
- All domestic and foreign corporations doing business in North Carolina are subject to the tax
- Doing business in North Carolina
  - Maintenance of office or place of business
  - Maintenance of inventory of merchandise for sale, distribution or manufacture
  - Selling of merchandise to customers in North Carolina from company owned vehicle

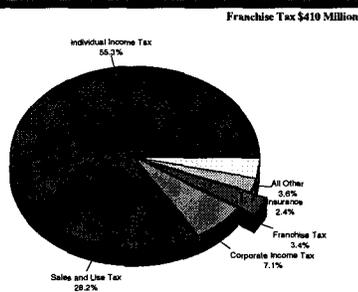
### CORPORATE INCOME TAX (Continued)

- Rendering of service to clients by agents or employees of a foreign corporation
- Owning, renting or operating business or income producing property
- Exempt -
  - S corporations
  - Insurance Companies (subject to gross premium tax)
  - Telephone and electric membership corporation
  - Cooperative board without capital stocks
  - Nonprofits

### CORPORATE INCOME TAX (Continued)

- Tax on state net income = federal taxable income
- Tax rate 7% for 1999 and 6.9% for 2000
- Tax credits - see Tax Expenditure handout
- Apportionment formula - property plus payroll plus twice the sales divided by four

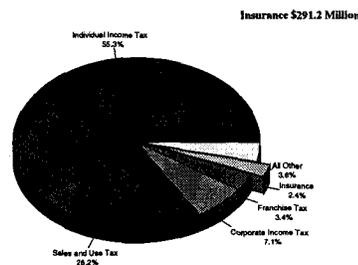
### GENERAL FUND REVENUE MAJOR TAX SOURCES (1998-99)



### FRANCHISE TAX

- Privilege or excise tax imposed on domestic and foreign corporations for the privilege of doing business and existing as a corporation under North Carolina law
- The franchise tax is measured by whichever of the following bases is greatest in amount:
  - (1) capital stock, surplus and undivided profits allocated to North Carolina
  - (2) 55% of the appraised value of real and tangible property or
  - (3) investment in tangible property in North Carolina
- Tax is \$1.50 per \$1,000, Minimum tax is \$35

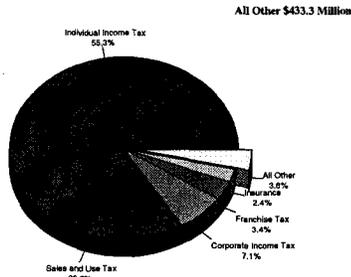
### GENERAL FUND REVENUE MAJOR TAX SOURCES (1998-99)



### INSURANCE PREMIUMS TAX

- Tax on gross premiums of life insurance policies covering North Carolina residents and gross premiums of other insurance policies covering risks in North Carolina
- 2.5% tax rate on Workers' Compensation insurance
- 1.9% on annuities and all other insurance contracts
- Additional 1.33% on fire and lightning coverage (except marine and auto)
- .5% Blue Cross Blue Shield

**GENERAL FUND REVENUE  
MAJOR TAX SOURCES (1998-99)**



**GIFT TAX**

- Spouse is exempt
- Three classes of rates
  - Lineal (child, stepchild, adopted child) 1% to 12%
  - Brother, Sister, Aunt, Uncle 4% to 16%
  - All Others 8% to 17%
- \$10,000 exclusion annually
- \$100,000 per donor lifetime exemption

**ALCOHOLIC BEVERAGE TAX**

- Spirituous liquors 28% of retail price
- Malt beverage 53.177¢ per gallon
- Fortified wines 24¢ per liter
- Unfortified wines 21¢ per liter

**CIGARETTE AND TOBACCO PRODUCTS TAX**

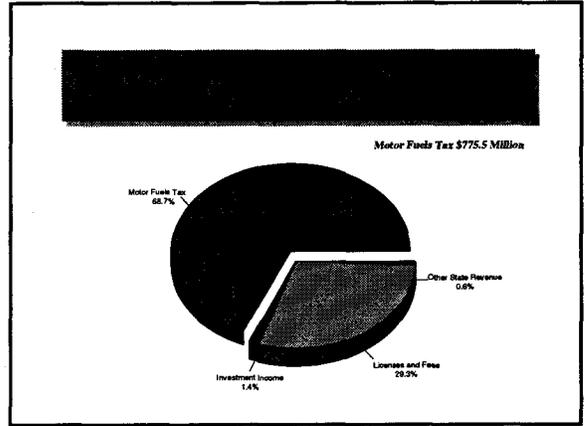
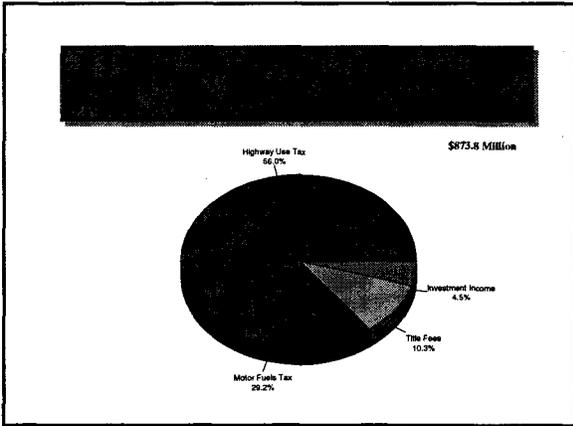
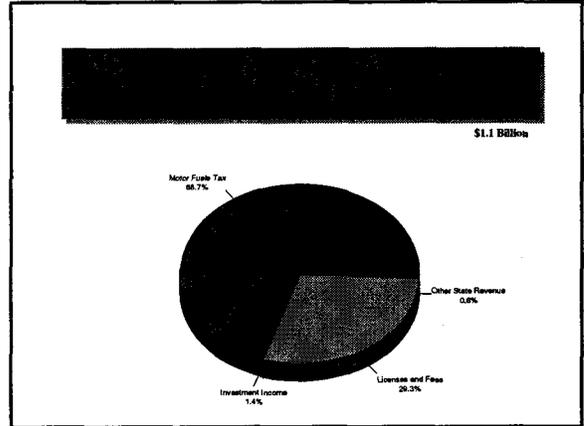
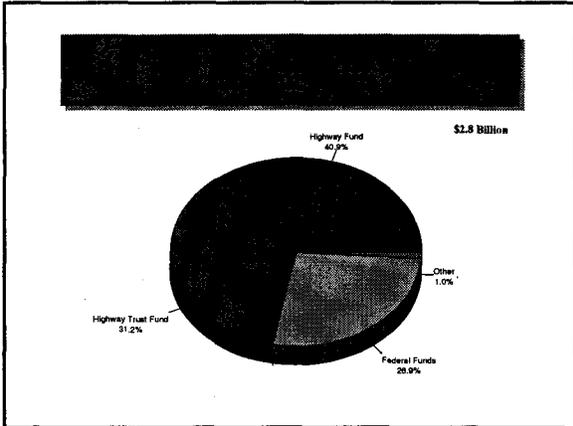
- 5¢ per package of 20 (2 1/2 mills per cigarette)
- Third lowest tax rate behind Virginia (2.5) and Kentucky (3)
- Other tobacco products = 2%

**REALTY TRANSFER TAX**

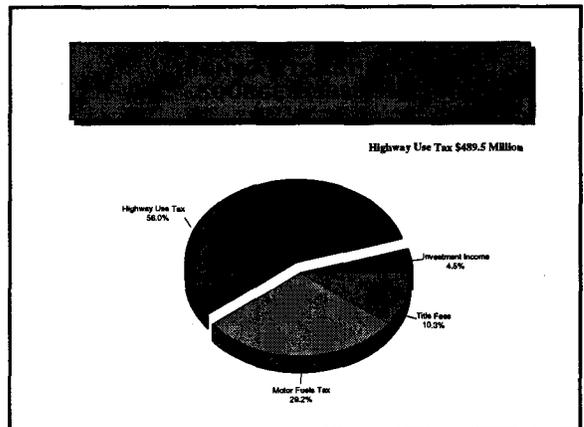
- \$1 is levied on each \$500 of property conveyed to another person
- Exemptions for transfers 1) by operation of law, 2) by lease for a term of years, 3) by will, 4) by intestacy, 5) by gift, 6) by merger, conversion, or consolidation, 7) by instruments securing indebtedness, 8) by governmental unit, or 9) where no consideration in property or money is due or paid by transferee to transferor.

**INHERITANCE (ESTATE TAX)**

- Repealed effective January 1, 1999
- Estate tax imposed in amount equal to federal state death tax credit



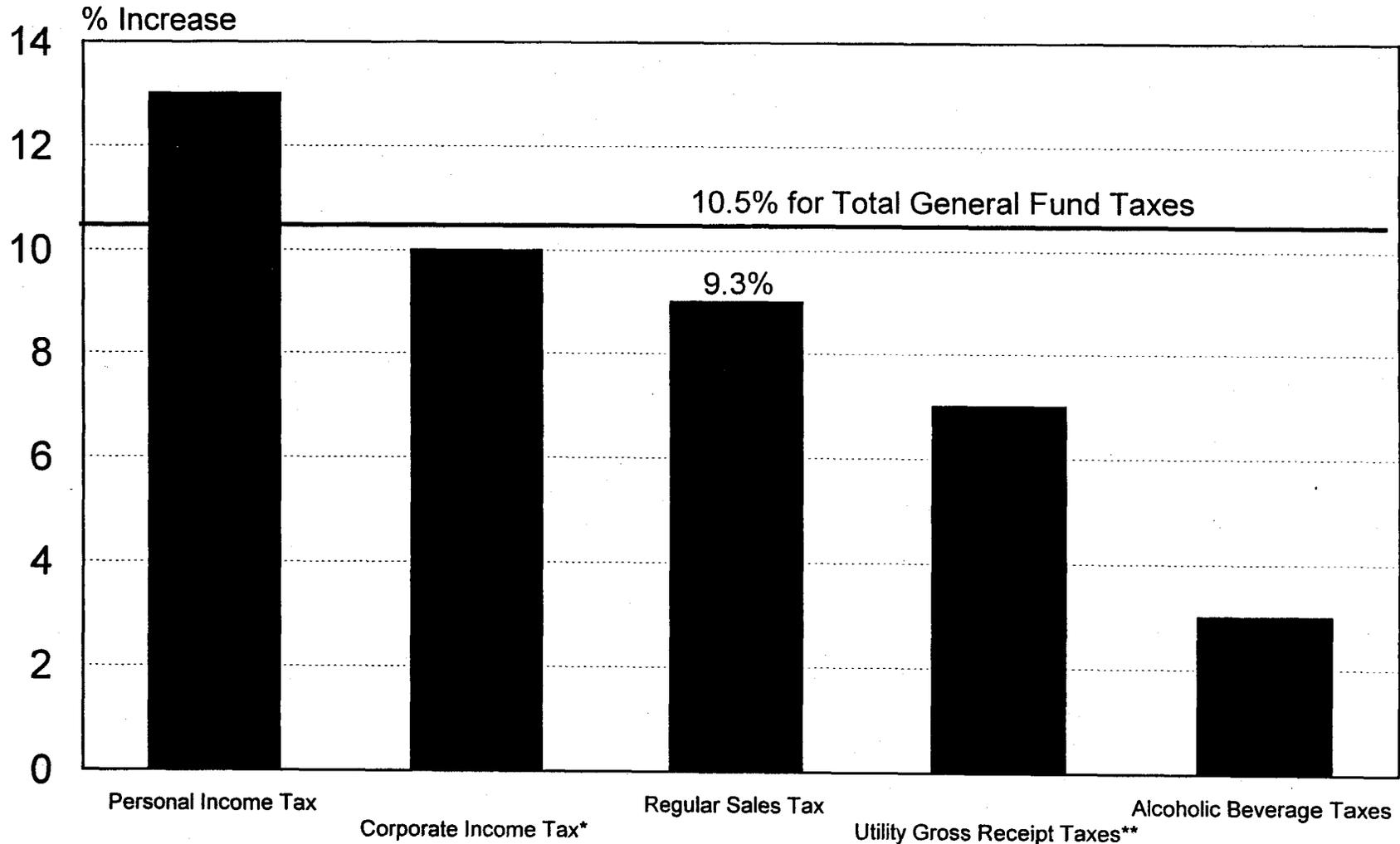
- Imposed on gasoline, kerosene, diesel, ethanol
- Taxed at the oil terminal rack
- 17.5¢/gallon plus the greater of 7% of the average wholesale price of motor fuel or 3.5¢/gallon
- Current tax rate is 22¢
- Three fourths of tax goes to Highway Fund and one fourth to Highway Trust Fund
- 1 3/4 cents goes to cities (Powell Bill)





- 1989 - replaced 2% sales tax on vehicle
- 3% of the retail value of a motor vehicle
- \$1,500 maximum
- Paid when vehicle is purchased or titled in North Carolina

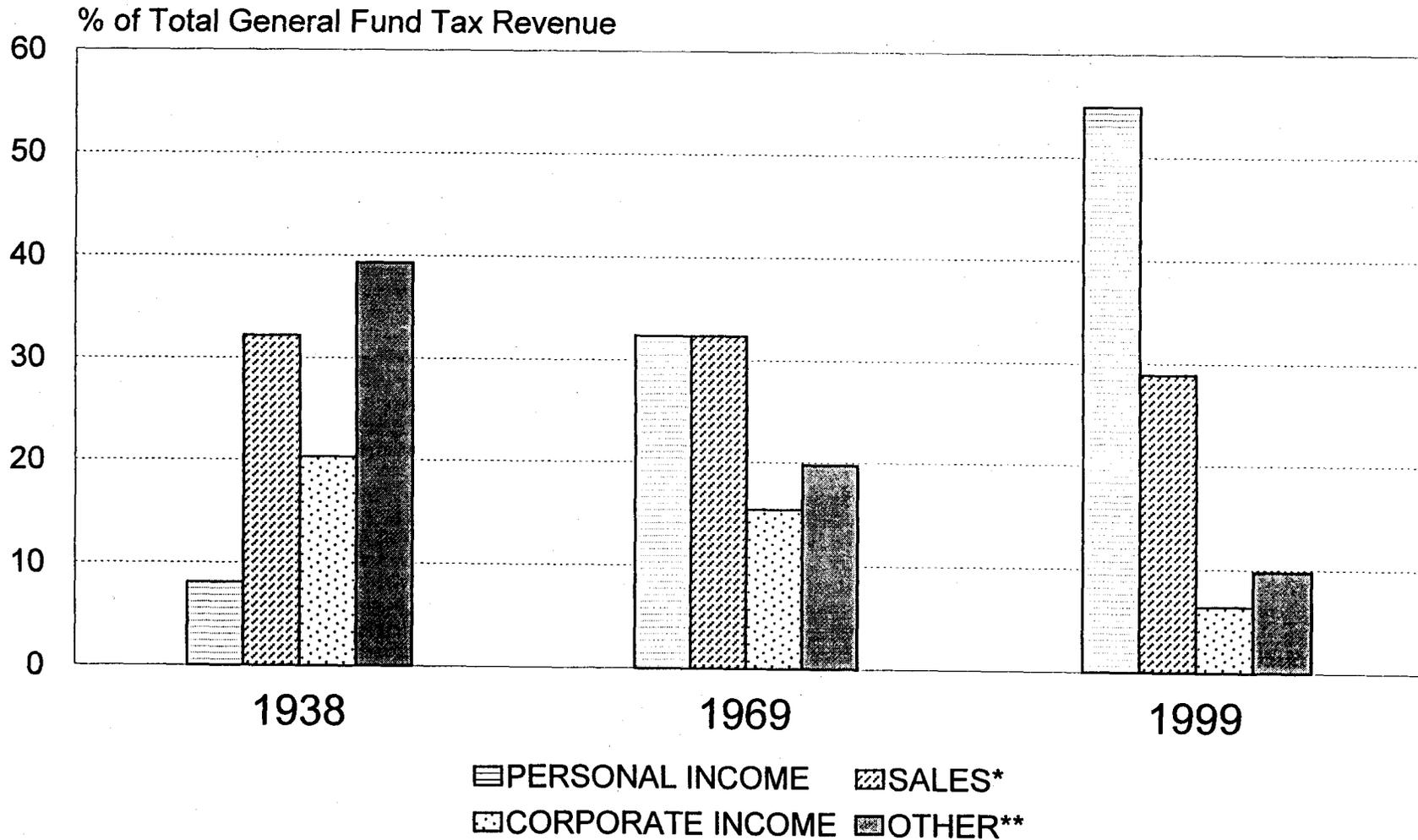
# HOW FAST CERTAIN TAX SOURCES INCREASE AS A RESULT OF 10% GROWTH IN THE INCOME OF STATE RESIDENTS



\*Based on long-run relationship.

Growth has slowed in recent years due to deregulation and other industry trends.

# THE PERSONAL INCOME TAX HAS "CROWDED OUT" OTHER MAJOR TAXES OVER TIME

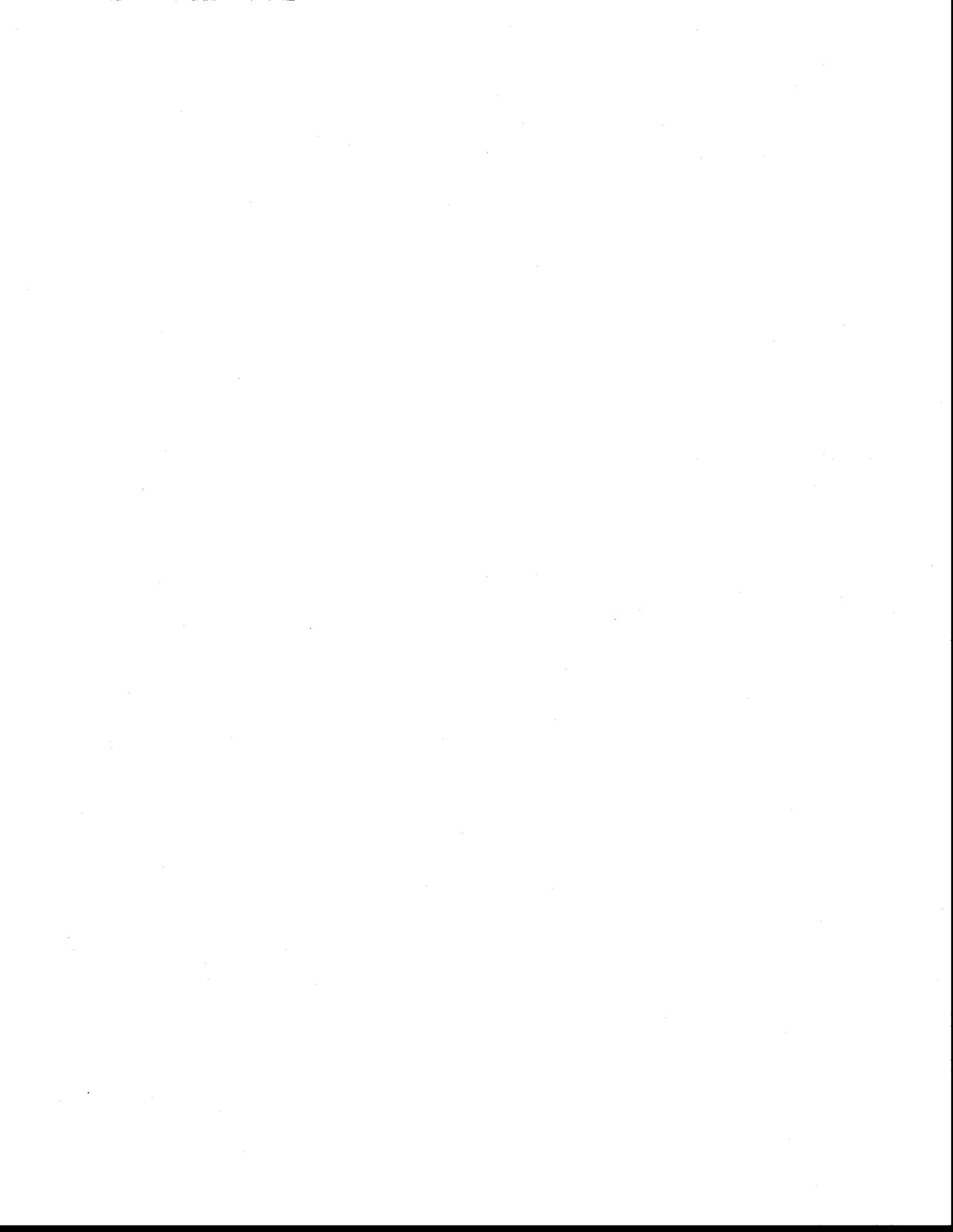


\*Rate was raised from 3% to 4% in 1991. Food for home consumption was eliminated from tax base between 1997 and 1999.  
 \*\*Comprised of many unit-based excise taxes.

# **EXHIBIT D**

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## **Local Revenue Sources**



## BASIC REVENUES AVAILABLE FOR MUNICIPALITIES

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### I. Taxes

A. **State-Shared Taxes:** Together total approximately 10-25% of a municipality's general fund revenues.

1. Gasoline Tax: (G.S. 136-41 through -41.3; Powell Bill Funds)
  - a. Total amount available for distribution: \$.0175 per gallon plus 6.5% of the net proceeds of the N.C. Highway Trust Fund
  - b. Distribution Formula
    - 1)  $\frac{3}{4}$  of total distributed on per capita basis
    - 2)  $\frac{1}{4}$  of total distributed according to number of miles of nonstate streets in each municipality
  - c. Restricted uses for moneys, i.e. curb and gutter, street cleaning, street construction and maintenance, etc.
2. State Franchise/Gross Receipts Tax on Electric and Telephone Utilities
  - a. State levies gross receipts tax on electric and telephone utilities to be shared with municipalities
  - b. State taxes at a rate of 3.22% of gross receipts
  - c. Distribution Formula: State shares 3.09% of the gross receipts derived from the utility's service within the municipality
  - d. Quarterly distribution
3. Excise Tax on Piped Natural Gas
  - a. State levies an excise tax on piped natural gas.
  - b. The tax rate is structured as a "declining block" that decreases as the amount of therms of piped gas consumed in a month increases.
  - c. Distribution Formula: 50% of the proceeds of the excise tax on piped natural gas collected in a municipality are distributed to that municipality.
4. Beer and Wine Tax
  - a. The percentage shared annually with counties and municipalities depends on type of beverage:

1) Beer:	23.75%
2) Unfortified Wine:	62%
3) Fortified Wine:	22%
  - b. Share only for the type of beverage that can sold within the municipality's boundaries
  - c. Distribution Formula: Shared based upon population, with county given credit for only unincorporated population

**B. Local**

1. Property Tax: Taxation based upon ownership of real and personal property located within municipal limits.
  - a. Property taxes typically account for 1/3 to 1/2 of general fund revenues.
  - b. Municipal board sets rate of taxation based upon estimated needs of the municipality up to \$1.50 per hundred dollars of value without a vote of the people. G.S. 160A-209
  - c. Vote of the people required prior to implementation for certain uses. G.S. 160A-209
  
2. Local-Option Sales and Use Tax:
  - a. Levied by the County, collected by the State, disbursed to municipality by the County.
  - b. Typically 10-15% of general fund revenues.
  - c. 3 separate local sales taxes
    - 1) Article 39 one-cent: returned to county of collection
    - 2) Article 40 half-cent: statewide pool allocated on per capita basis
    - 3) Article 42 half-cent: statewide pool allocated on per capita basis
  - d. County selects one of two allocation methods among governmental units within the county.
    - 1) Per Capita Method. The proportion of total population, county plus each municipality.
    - 2) Ad Valorem Method. Based on proportion of total property taxes levied, county plus municipality.
  - e. Restrictions on use
  
3. Privilege License Tax:
  - a. Imposed on the privilege of carrying on a business or engaging in certain occupations
  - b. very flexible, but must be uniform
  
4. Cable Television Franchise Tax: up to 5% of gross receipts
  
5. Animal Tax (G.S. 160A-212): usually not over \$5.00 per animal
  
6. Motor vehicle license tax (G.S. 20-97): not to exceed \$5.00 per vehicle
  
7. 911 surcharge: to fund E-911 projects
  
8. The following taxes may be permitted by local act:
  - a. Occupancy Taxes
  - b. Meals Taxes
  - c. Impact Taxes

**II. User Charges (examples; rates set by municipality)**

- A. Water and Sewer.
  - 1. Typically 15-25% of general fund revenue
  - 2. Normally operated as public enterprise
- B. Electric Power and Gas Services
- C. Solid Waste Collection and Disposal
- D. Public Transportation
- E. Recreation

**III. Other**

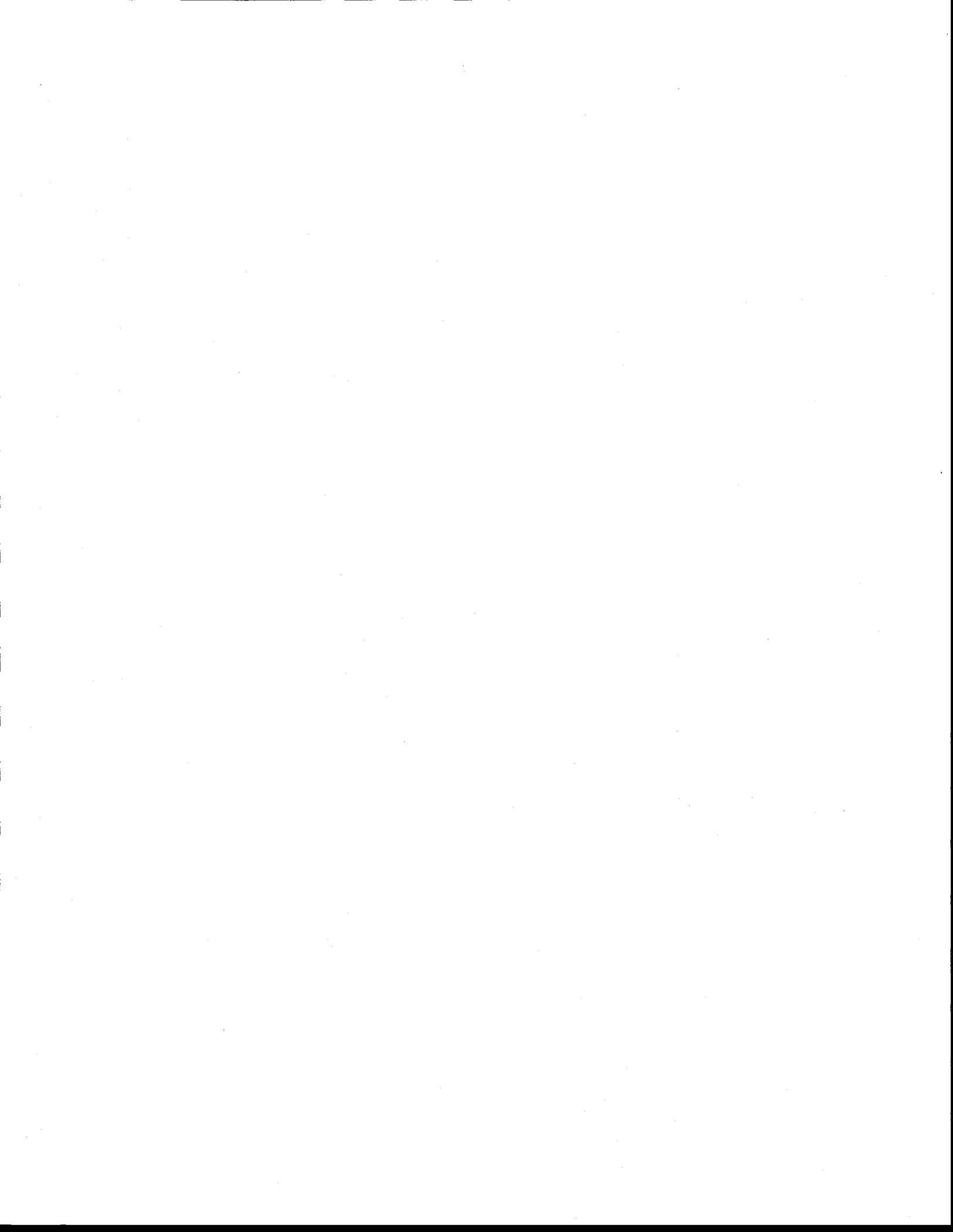
- A. Grants
- B. Investment Earnings
- C. Special Assessments
- D. Fees incidental to regulation, i.e. building inspection fees, sanitarian fees

**IV. Restriction on receipt:** For a municipality incorporated on or after January 1, 2000, it must comply with G.S.136-41.2 (election, budget, tax rate, 4 services) and have a majority of its streets open to the public in order to receive the following tax revenues:

- A. Local sales and use tax
- B. Beer and wine excise tax
- C. Gross receipts tax on electric power companies
- D. Gross receipts tax on telephone companies

Prepared by: Erika Churchill  
Cindy Avrette  
Research Division

Last edited: March 2, 2000S



**BASIC REVENUES AVAILABLE FOR COUNTIES**  
**March 8, 2000**

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**I. Taxes**

**A. State-Shared Taxes**

1. Beer and Wine Tax G.S. 105, Article 2
  - a. Percentage shared with counties and cities by State depends on type:
    - 1) Beer: 23.75%
    - 2) Unfortified Wine: 62%
    - 3) Fortified Wine: 22%
  - b. Share only for the type of beverage that can be sold within boundaries
  - c. Distribution Formula: share based upon population with county given credit for only unincorporated population
  - d. Annual distribution
2. Real Estate Transfer Taxes (G.S. 105, Article 8E)
  - a. Tax levied on each recorded deed, with some exceptions
  - b. Collected by Register of Deeds Office and paid to the county in which the property is located
  - c. Rate: \$1.00 for each \$500.00 of value
  - d. Distribution Formula: County retains ½ of amount collected plus 2% of the remaining one half remitted to the State

**B. Local**

1. Property Tax: Taxation based upon ownership of real and personal property located within county boundaries.
  - a. Property taxes typically account for 40-60% of general fund revenues.
  - b. Vote of the people required prior to implementation for certain uses. G.S. 153A-149
  - c. Rate: County Board of Commissioners sets rate of taxation based upon estimated needs of the county up to \$1.50 per hundred dollars of value without a vote of the people. G.S. 153A-149.
2. Local-Option Sales and Use Tax: from sales of goods and occupancy
  - a. Levied by the County, collected by the State, disbursed back to County.
  - b. Typically 15-25% of general fund revenues.
  - c. Decision to levy the local-option sales and use taxes is solely a decision of the county, and currently all do.
  - d. Portion of amount remitted back to County is shared with all municipalities in the county
  - e. Collection via three (3) separate local sales taxes:
    - 1) Article 39 one-cent (G.S. 105): returned to county of collection

- 2) Article 40 half-cent (G.S. 105): statewide pool allocated on per capita basis
- 3) Article 42 half-cent (G.S. 105): statewide pool allocated on per capita basis
- f. Distribution: County selects one of two allocation methods among governmental units within the county.
  - 1) Per Capita Method. The proportion of total population, county plus each municipality.
  - 2) Ad Valorem Method. Based on proportion of total property taxes levied, county plus municipality.
  - 3) Selection made be changed in April for the upcoming fiscal year
- g. Restrictions imposed on use by authorizing statutes
- 3. Privilege License Tax (G.S. 153A-152)
  - a. Imposed on the privilege of carrying on a business or engaging in certain occupations
  - b. Flexible, but must be uniform
- 4. Franchise Tax
  - a. Cable Television (G.S. 153A-154): limits on amount may be imposed by federal law (Telecommunications Act of 1996).
  - b. Although a County can grant several types of franchises, cable is the only franchise type specifically given authority to tax.
- 5. Animal Tax (G.S. 153A-153): usually not over \$5.00 per animal.
- 6. Motor vehicle license tax (G.S. 20-97): not to exceed \$5.00 per vehicle
- 7. 911 surcharge (G.S. 62A)
  - a. To fund E-911 projects with stated parameters for expenditures.
  - b. Collected by telephone company and remitted back to County.
  - c. Rate set by ordinance of Board of County Commissioners.
- 8. Occupancy Taxes: permitted by local act and levied on occupancy of hotel and motel rooms.

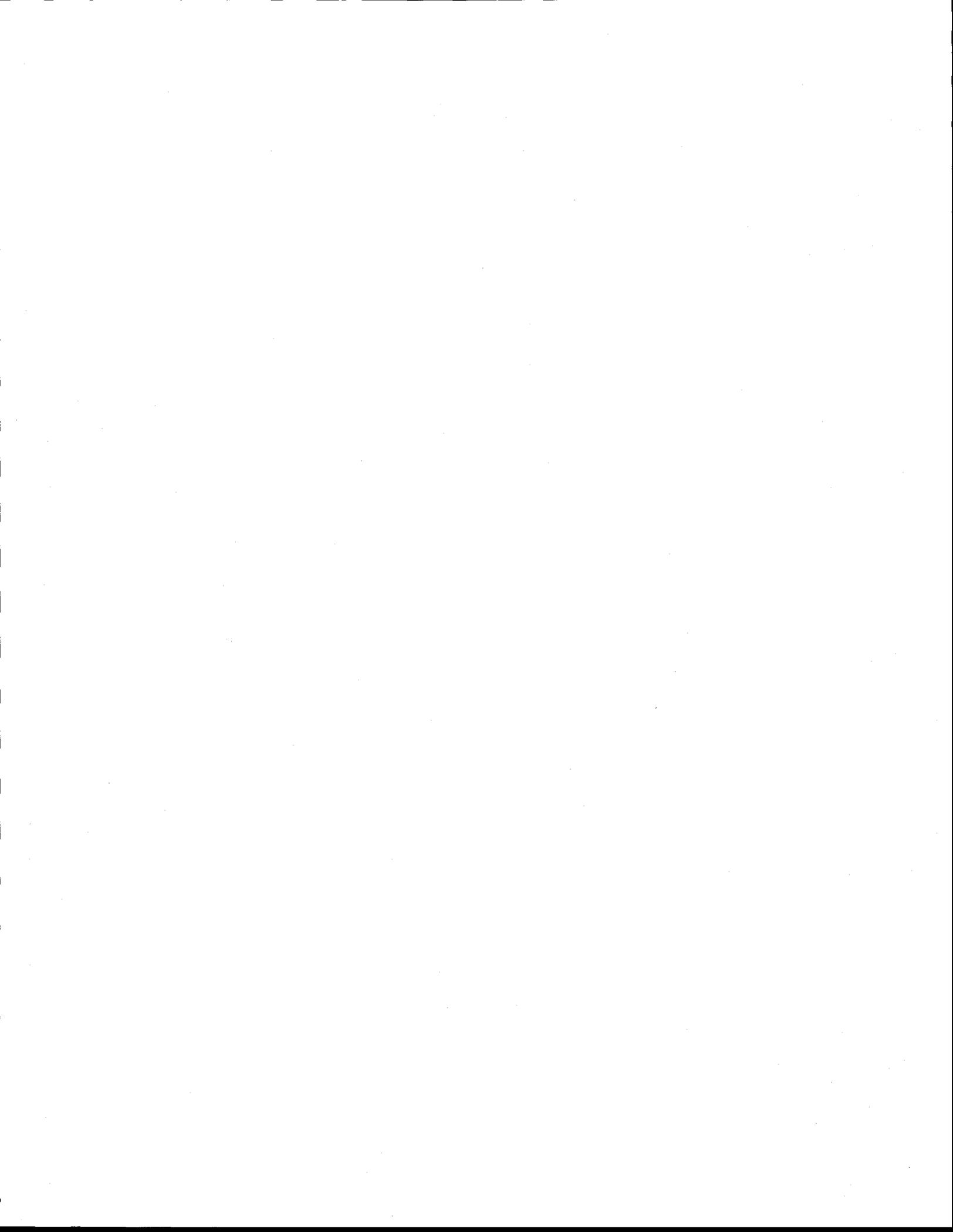
**II. User Charges (examples; rates set by county)**

- A. Water and Sewer
  - 1. Normally operated as public enterprise
  - 2. Rates set by county are not subject to Utilities Commission regulation
- B. Solid Waste Collection and Disposal
- C. Airports
- D. Hospitals
- E. Ambulance and Rescue Services
- F. Public Transportation
- G. Recreation
- H. Off-Street Parking Facilities

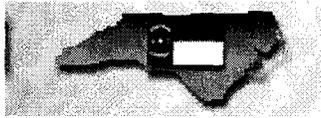
**III. Other Local Fees/Revenue**

- A. Statutory Fees of Public Officers
  - 1. Sheriff

- a. Service of Papers: \$5.00 per paper served
  - b. Civil Process Fees: from collection of money judgments
    - Rate: 5% of first \$500.00 plus 2 ½ % of amount over \$500.00
  - c. Jail Fees: (G.S. 7A-313): \$5.00 per day for pre-trial inmates ultimately convicted
2. Register of Deeds (G.S.161-10)
- a. Marriage License: \$40.00
  - b. Administering an Oath: \$3.00
  - c. Recordation Fees
    - 1) Deeds of Trust/Mortgages: \$10.00 First Page, \$2.00 for each additional page
    - 2) Documents: \$6.00 First page, \$2.00 for each additional page
    - 3) Plats: \$21.00
- B. Fees Incidental to Regulation
- 1. Building Inspections
  - 2. Environmental Health
  - 3. Planning and Zoning Regulation
- C. Impact Fees: Local legislation required
- D. Special Assessments (Chapter 153A, Article 9)
- E. Grants
- F. ABC Store Profits
- G. Investment Earnings
- H. Sale/Rental of Property



## Sources of Local Revenue



Linda Struyk Millsaps  
Fiscal Research  
for the  
North Carolina Tax Policy Commission

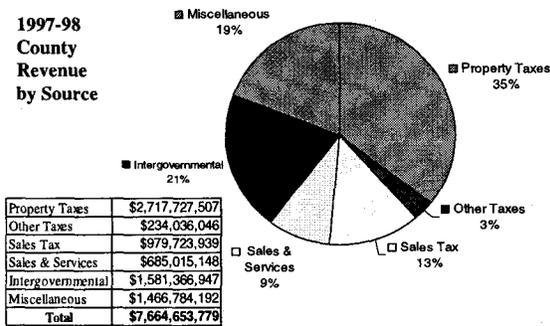
## Sources of Local Revenue

- Sources of Local Revenue
  - County
  - Municipal
- Local Taxes and Fees
  - Property Tax
  - Sales Tax
  - Occupancy Tax
  - Meals Tax
  - Impact Fees
  - Other Fees and Services
- State Aid to Local Units
  - Tax Sharing
  - Reimbursements



## Sources of Local Revenue: County

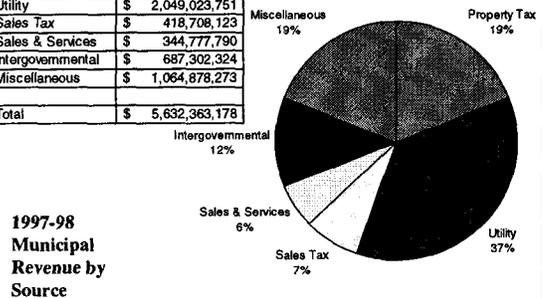
1997-98  
County  
Revenue  
by Source



Information provided by the Local Government Commission.

## Sources of Local Revenue: Municipal

Property Tax	\$ 1,067,672,917
Utility	\$ 2,049,023,751
Sales Tax	\$ 418,708,123
Sales & Services	\$ 344,777,790
Intergovernmental	\$ 687,302,324
Miscellaneous	\$ 1,064,878,273
<b>Total</b>	<b>\$ 5,632,363,178</b>



1997-98  
Municipal  
Revenue by  
Source

## Sources of Local Revenue

- Sources of Local Revenue
  - County
  - Municipal
- Local Taxes and Fees
  - Property Tax
  - Sales Tax
  - Occupancy Tax
  - Meals Tax
  - Impact Fees
  - Other Fees and Services
- State Aid to Local Units
  - Tax Sharing
  - Reimbursements



## Local Taxes and Fees: Property Tax

- All taxable property is taxed at the same rate.
- Both counties and municipalities can levy a property tax.
- How the property is used may impact its tax status (Farm Use, Forest, Conservation).
- Government and some non-profit property is exempt.
- A Homestead exemption serves to lower low income elderly tax burdens.



## Local Taxes and Fees: Property Tax



North Carolina counties depend on property taxes for 65%-70% of local government tax collections.

*Of the ten most populated states, North Carolina had the lowest property tax burden.*

North Carolina localities are able to limit property taxes because most school operating costs, as well as the construction and maintenance of most roads, are borne by the state.

## Local Taxes and Fees: Sales Tax



Collected from local merchants.

*The general rate of tax is 4% state, 2% local.*

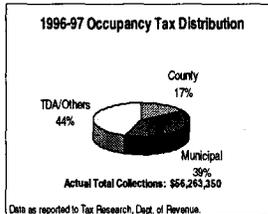
This relatively standard rate is often held up as a model for other states.

Food is exempt from state tax but is still subject to a 2% local tax.

*Distribution of sales tax revenue to localities is made on both per capita and point of sale basis.*



## Local Taxes and Fees: Occupancy Tax



• 65 counties have the authority to levy a county occupancy tax.

• 33 municipalities have their own occupancy tax.

• Counties are most likely to give their revenue to municipalities or to a Tourism Development Authority.

• Municipalities are most likely to retain their revenue.

• Occupancy taxes must be created by the General Assembly, usually through session laws.

## Local Taxes and Fees: Meals Tax

● Since 1989 the General Assembly has ratified local bills giving two municipalities and four counties the authority to levy an additional 1% tax on prepared food.

● **Municipalities:** Charlotte, Hillsborough.

● **Counties:** Cumberland, Dare, Mecklenburg, and Wake.

● **Note:** In Charlotte only the county or city tax can apply.



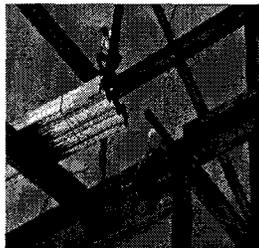
## Local Taxes and Fees: Impact Fees

• Also called development or facility fees.

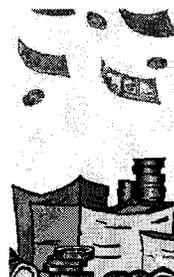
• Generally assessed on developers for streets, water lines, sewer, and other infrastructure.

• Some municipalities with impact fees include Chapel Hill, Carrboro, and Rolesville.

• May be the wave of the future in urban areas.



## Local Taxes and Fees: Other



• **Motor Vehicle Tax** - \$5 to \$30 per vehicle, local option.

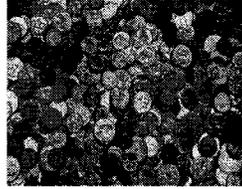
• **Land Transfer Tax** - Tax on Conveyances (some authorized counties).

• **Local Transit Revenue Options** (for public transit, local option).

• **Utilities** - Significant for municipalities. Includes water, sewer, power, gas, solid waste.

### Local Taxes and Fees: Other (cont.)

- Privilege License Tax - Business or Occupation based. Flexible.
- Cable TV Franchise Tax - Up to 5% G.R.
- Animal Tax
- 911 Surcharge.
- Other User Charges - Airports, Ambulance. Usually county.



- Register of Deeds Fees - Marriage License, Oaths, Recording Fees.
- Regulatory Fees - Building and Environmental.

### Sources of Local Revenue

- Sources of Local Revenue
  - County
  - Municipal
- Local Taxes and Fees
  - Property Tax
  - Sales Tax
  - Occupancy Tax
  - Meals Tax
  - Impact Fees
  - Other Fees and Services
- State Aid to Local Units
  - Tax Sharing
  - Reimbursements



### State Aid to Local Units

#### State Taxes Shared with Counties



#### Beer and Wine Tax

- Shared only for the types of beverages allowed in the county.
- Distribution is based on the type of beverage.

#### Real Estate Transfer Tax

- Also known as the Deed Tax. County Retains 50%+.
- \$1.00 tax for each \$500.00 in value transferred.

### State Aid to Local Units

#### State Taxes Shared with Municipalities

- Gasoline Tax - Shared through Powell Bill Funds. Restricted Use.
- Franchise and G.R. Tax on Electricity and Telephones
- Excise Tax on Piped Natural Gas.
- Beer and Wine Tax.



### State Aid to Local Units

#### Reimbursements for Law Changes

##### Counties (in millions)

Inventories	
Manufacturers	75.2
Retail/Wholesale	52.6
Intangibles	92.0
Food Stamps	4.6
Homestead	8.3
<b>Total</b>	<b>232.7</b>

##### Municipal (in millions)

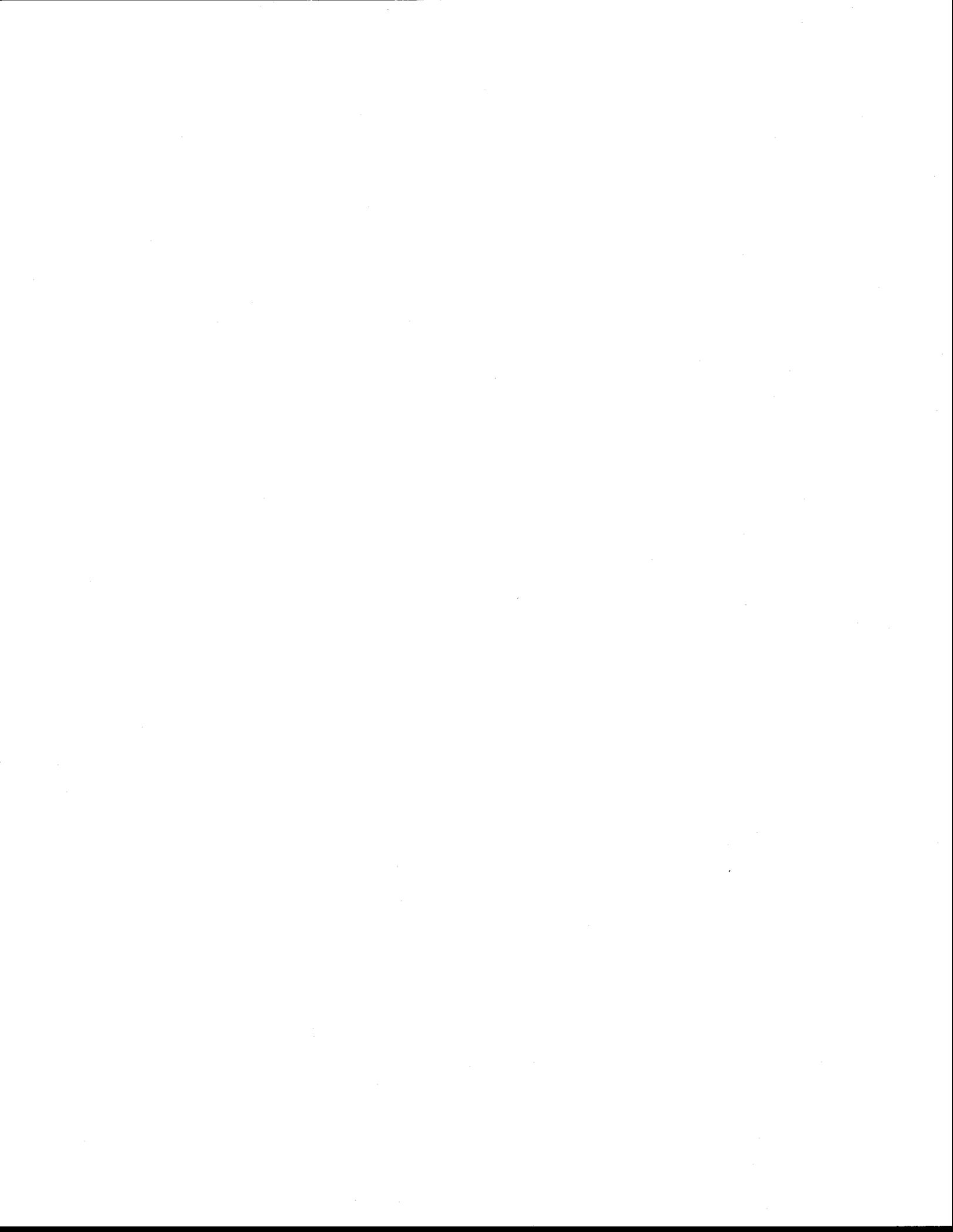
Inventories	
Manufacturers	32.9
Retail/Wholesale	29.5
Intangibles	37.0
Food Stamps	1.7
Homestead	2.4
<b>Total</b>	<b>103.5</b>

### Sources of Local Revenue

- Sources of Local Revenue
  - County
  - Municipal
- Local Taxes and Fees
  - Property Tax
  - Sales Tax
  - Occupancy Tax
  - Meals Tax
  - Impact Fees
  - Other Fees and Services
- State Aid to Local Units
  - Tax Sharing
  - Reimbursements

#### Summary:

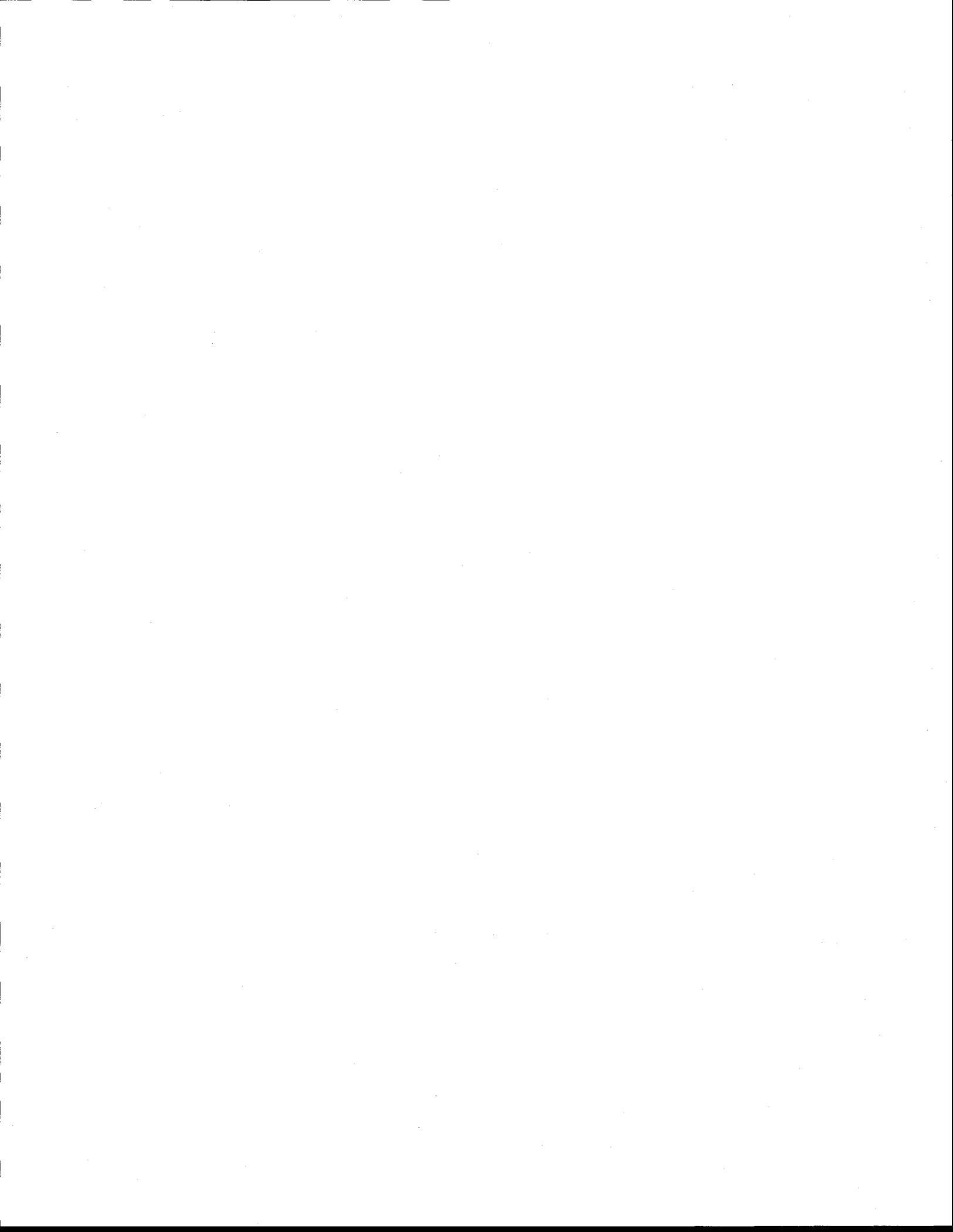
- Counties & Municipalities rely heavily on property taxes.
- Municipalities also rely on utility revenue.
- Debt tools are impacting local finance.
- Locals have a lot of revenue raising options, but none can replace the property tax or utilities.
- Tax sharing is significant, reimbursements are not.



# **EXHIBIT E**

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## **State Revenue Structure**



# STATE REVENUE STRUCTURE

**Richard Bostic**  
Fiscal Research Division

1

## NCSL REVENUE STANDARDS

- NCSL published the "Principles of a High Quality State Revenue System" in 1988
- The principles are as follows:
  - Composed of elements that function well together in a logical system
  - Produce revenue in a reliable manner
  - Substantial diversification of revenue sources over reasonably broad base
  - Equitable, avoid regressivity, similar incomes bear similar tax burdens

2

## NCSL REVENUE STANDARDS

- Understandable, raise revenue efficiently, minimize taxpayer compliance costs, simple to administer
- Accountability
- Administered professionally and uniformly
- Minimize interstate tax competition and business tax incentives
- Not be used as instrument of social policy to encourage particular activities
- Provide local governments with revenue to provide adequate level of service

3



4

## INDIVIDUAL INCOME TAX

- Largest source of state tax revenue (all states equal 33.9% in 1998)
- 41 states have broad-based income taxes (Tennessee and new Hampshire have limited income tax on interest, dividends, and capital gains)
- 36 states have graduated rate structure
- 5 states have a single flat rate on all income

5

## INDIVIDUAL INCOME TAX

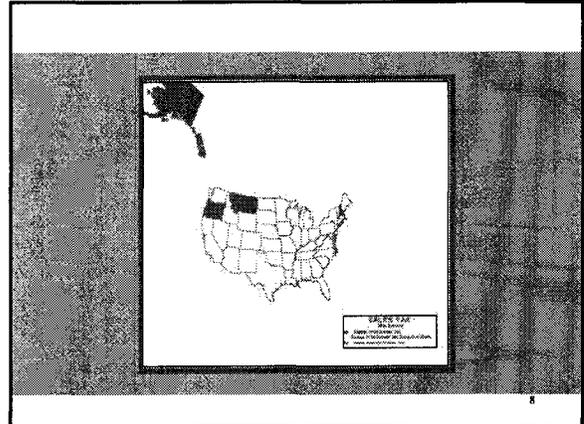
- Massachusetts levies flat tax of 5.95% on wages and salaries and 12% on interest, dividends and capital gains
- 16 states index tax brackets or personal exemption for inflation
- 27 states use federal adjusted gross income as starting point
- North Carolina is one of 7 states that use federal taxable income

6

### INDIVIDUAL INCOME TAX

- Three states use percentage of federal tax paid
- Only four states do not use the federal tax code as a starting point
- 11 states offer an earned income tax credit as a percentage of federal
- State income tax is deductible on federal tax return

7



8

### SALES AND USE TAX

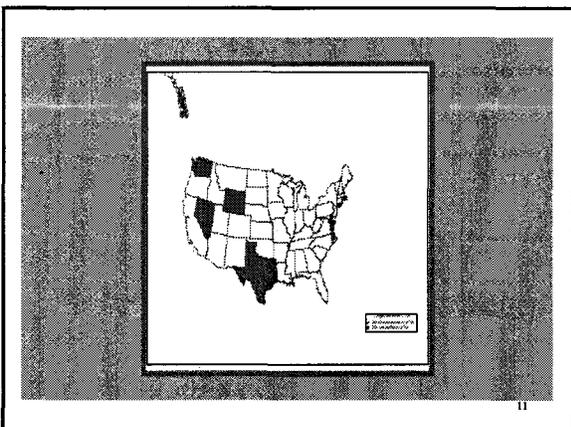
- Second largest source of state tax revenue (32.9% in 1998)
- Levied in 45 states
- 30 states allow local option sales tax
- 27 states exempt food
- All but Illinois exempt prescription drugs

9

### SALES AND USE TAX

- Rates range from 3% in Colorado to 7% in Rhode Island
- Connecticut, Iowa, South Dakota, Texas and West Virginia tax a number of consumer services

10



11

### CORPORATE INCOME TAX

- Third largest state revenue source (6.5% in 1998)
- 23 states use net income as the basis for levying tax
- 20 states use net income and net worth to determine tax liability
- 31 states use a flat rate tax ranging from 4% in Kansas to 9.9% in Pennsylvania

12

### CORPORATE INCOME TAX

- 14 states use graduated rates
- 12 states apportion income equally to sales, payroll and property
- 21 states use a double weighted sales factor

13

### MOTOR FUELS TAX TAX

- Imposed in all 50 states (6% of state revenues in 1998)
- Earmarked to highway or transportation trust funds
- Tax ranges from 7.5¢/gallon in Georgia to 32¢ in Connecticut
- 34 states tax at the distributor level and 8 states tax at the terminal rack

14

### MOTOR FUELS TAX TAX

- All but Alaska and Hawaii participate in International Fuel Tax Agreement (IFTA) to report fuel use by motor carriers in each state

15

### CIGARETTE AND TOBACCO TAXES

- Levied in all states
- Range from 2.5¢ per pack in Virginia to \$1.00 per pack in Alaska
- 1997 median rate was 31¢ per pack

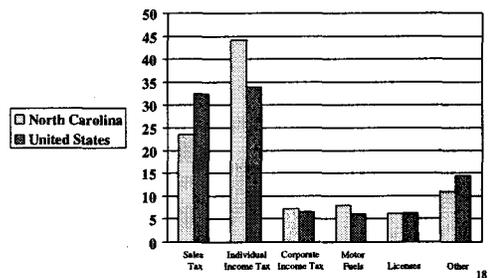
16

### ALCOHOLIC BEVERAGE TAX

- Levied in all states
- 34 states license retailers to sell liquor, beer, and wine and impose excise tax at wholesale level
- 16 states have government owned stores to sell liquor and license stores to sell beer and wine

17

### NORTH CAROLINA vs UNITED STATES SHARE OF STATE REVENUE



18

### TAX BURDEN

- North Carolina ranked 17 in state tax collections per capita in 1996
- North Carolina ranked 18 in state tax collections per \$1,000 in personal income in 1996
- North Carolina ranked 38 in 1999 for state and local taxes as percent of income
- North Carolina ranked 40 in 1999 for state, local, and federal taxes as percent of income

19

### DISTRICT OF COLUMBIA STUDY

- Compares tax burdens in the District to the largest city in each state
- Models a hypothetical family of four
- Income set at \$25,000, \$50,000, \$75,000, \$100,000 and \$150,000
- At the \$25,000 income level, Charlotte ranked 31st at \$1,807 in state and local taxes

20

### DISTRICT OF COLUMBIA STUDY

- At the \$100,000 income level, Charlotte ranked 26 at \$9,575 in state and local taxes
- The property tax burden at the \$100,000 income level had Charlotte ranked 43, but income tax burden ranked Charlotte 14

21

### TAX BURDEN ON BUSINESS

- Study in 1994 compared 12 Southeastern States
- Before Bill Lee Act and corporate rate reduction to 6.9%
- Measured state and local tax burden on manufacturing corporations
- North Carolina ranked 9 among the 12 Southeast states (6th for banks)

22

### STATE SHARE OF STATE/LOCAL EXPENDITURES

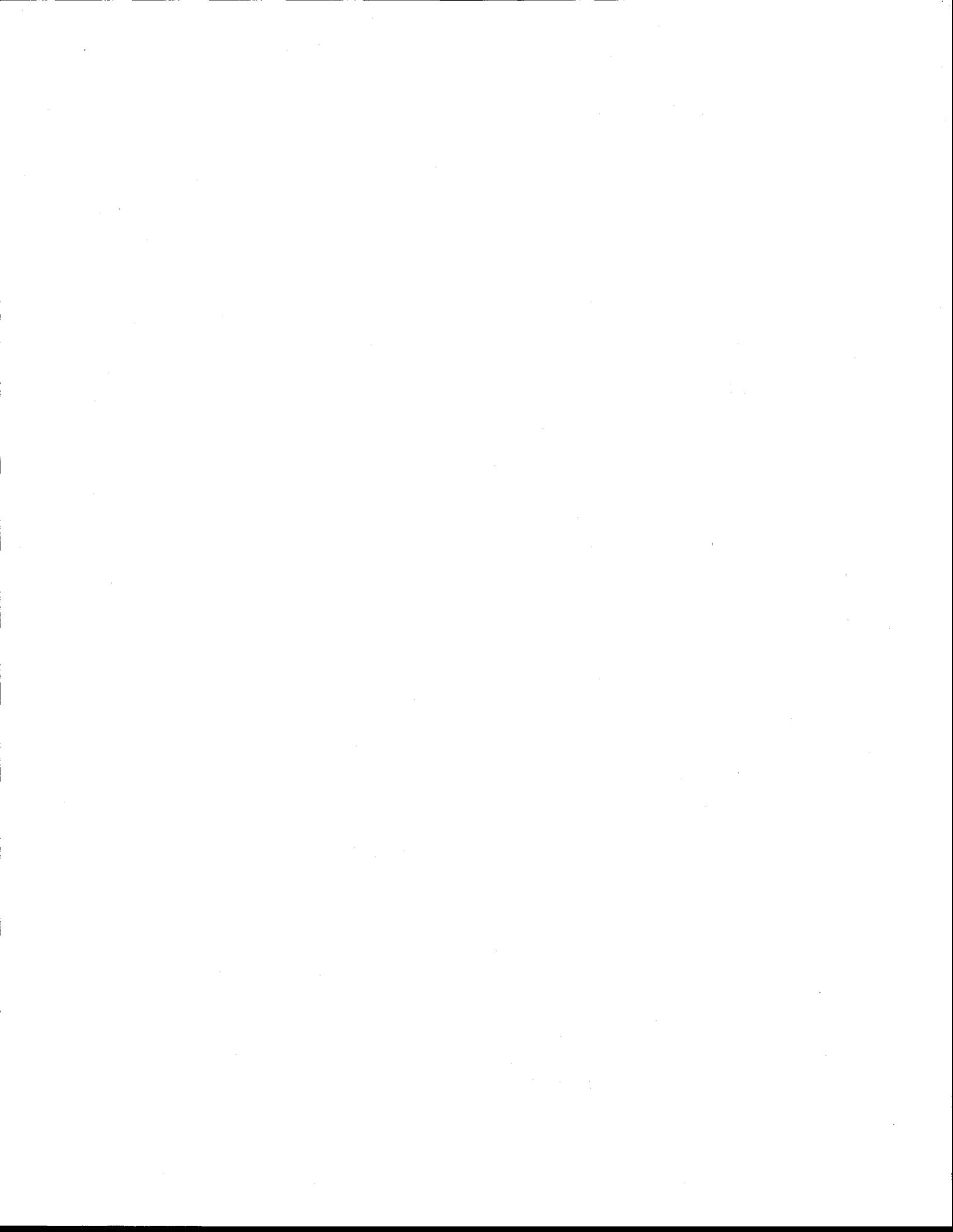
- North Carolina funds 81.1% of state/local corrections costs; ranking 11th
- North Carolina funds 89.2% of state/local judicial costs; ranking 5th
- North Carolina funds 84.1% of state/local highway costs; ranking 3rd
- North Carolina funds 65.4% of total public elementary and secondary school costs; ranking 4th

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# **EXHIBIT F**

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*“Is North Carolina’s Tax System Ready  
for the 21<sup>st</sup> Century”*



**IS NORTH CAROLINA'S TAX  
SYSTEM READY FOR THE 21<sup>ST</sup>  
CENTURY?**

**Presentation to the North Carolina  
Tax Study Commission**

**March 15, 2000**

**Dan Gerlach  
Director  
NC Budget & Tax Center  
PO Box 28068  
Raleigh, NC 27611-8068  
(919) 856-2158**

[btc@ncjustice.org](mailto:btc@ncjustice.org)

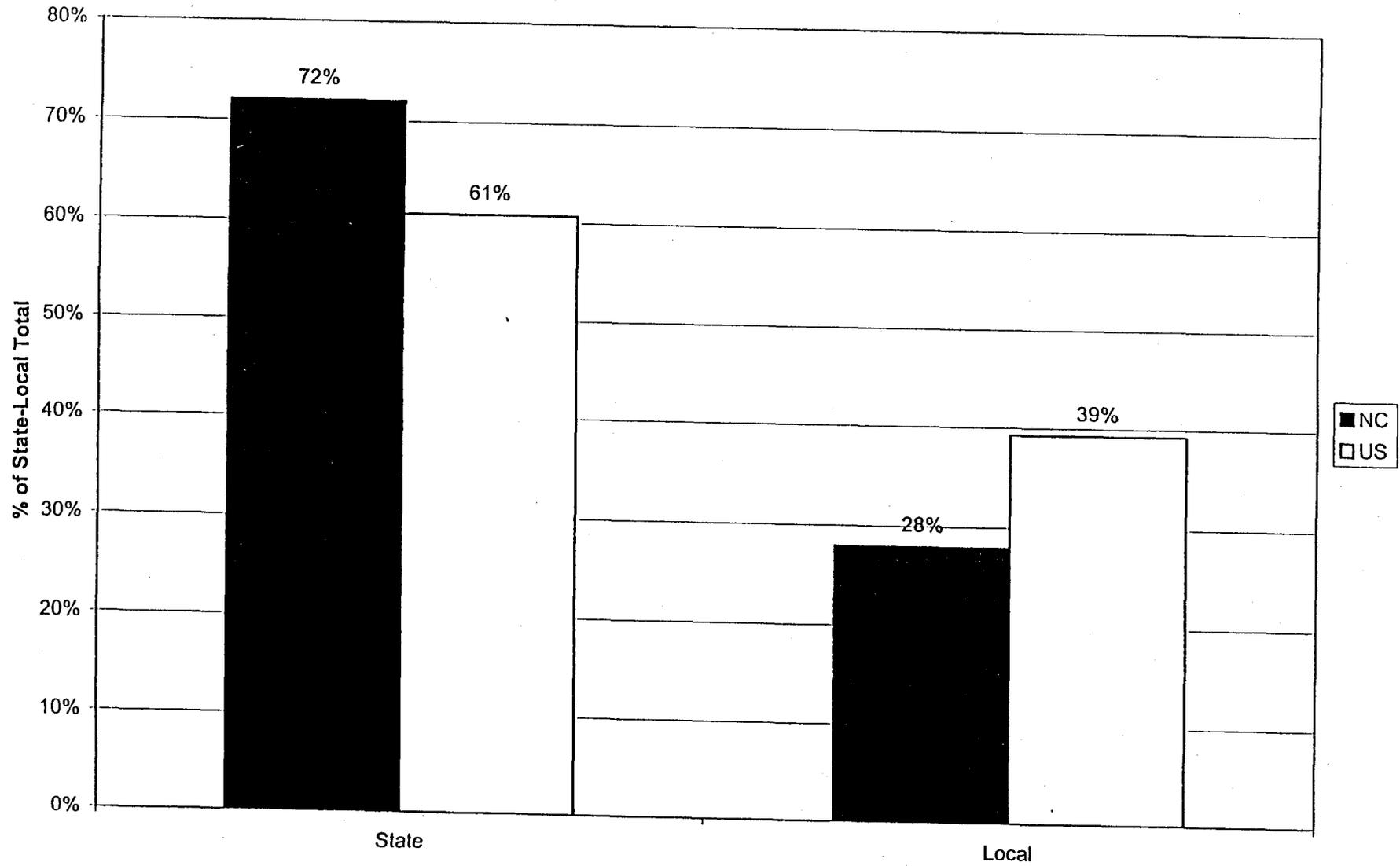
# **WHAT IS A GOOD TAX SYSTEM?**

- **Does it (and will it) raise enough money for the ongoing needs of government?**
- **Does it treat taxpayers equitably?**
  - **Those with less resources should pay less**
  - **Those with similar resources should pay about the same**

## **CURRENT CHARACTERISTICS OF NORTH CAROLINA TAX CODE**

- 1. Tax Levels Slightly Below National Average and About Average for Southeast**
- 2. Dependence on Income Tax Allows State Tax Levels to Keep Pace with Expenditure Needs**
- 3. State Pays Much Higher Share of Service Cost than do Other State Governments**
- 4. Tax Policy Driven By Court Cases & Economic Development – Making Code Less Progressive**
- 5. Tax Policy Driven By Political Ease – Lottery, Local Sales Tax – Making Code Less Progressive**

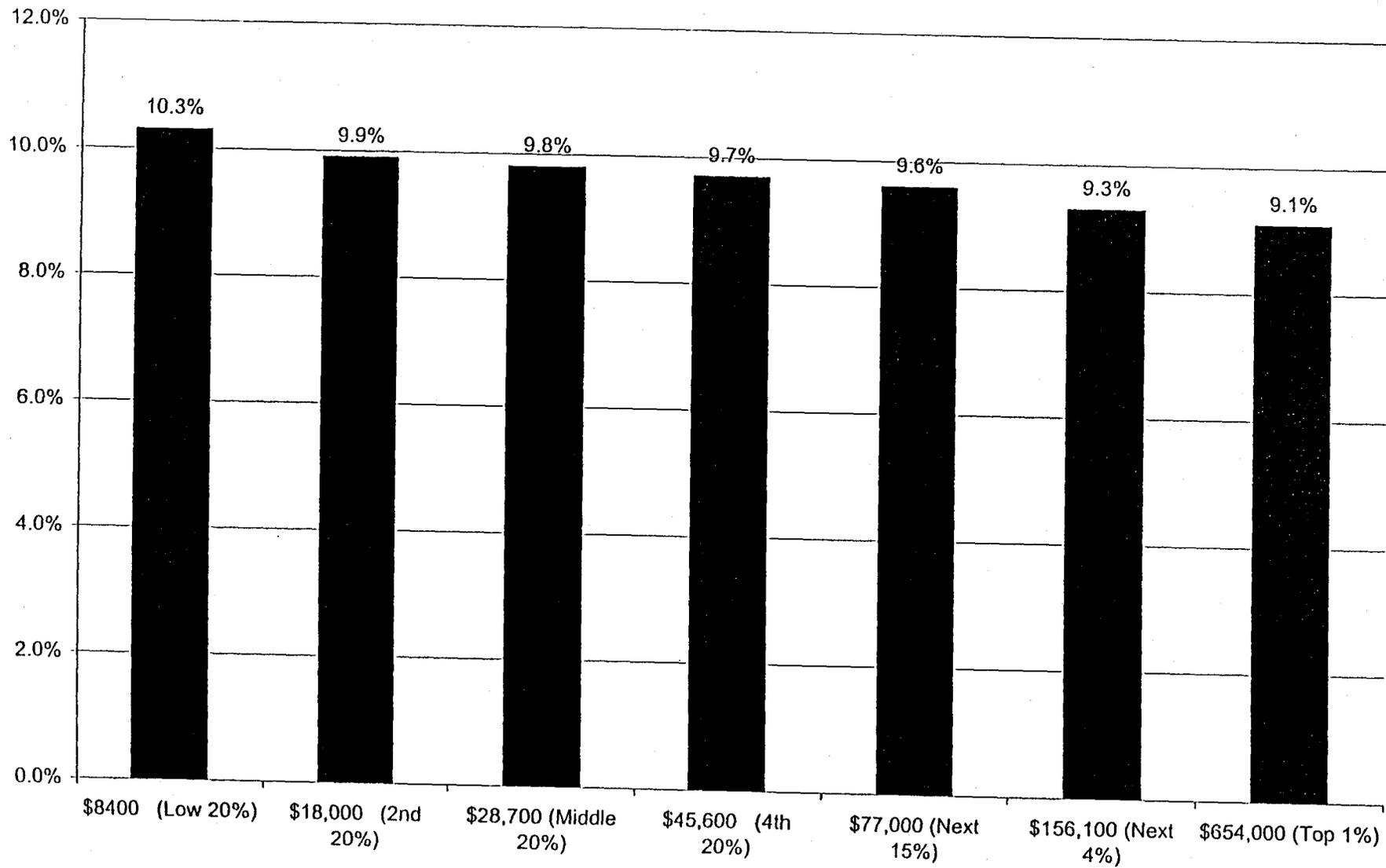
### Who Levies the Taxes? State or Local Governments?



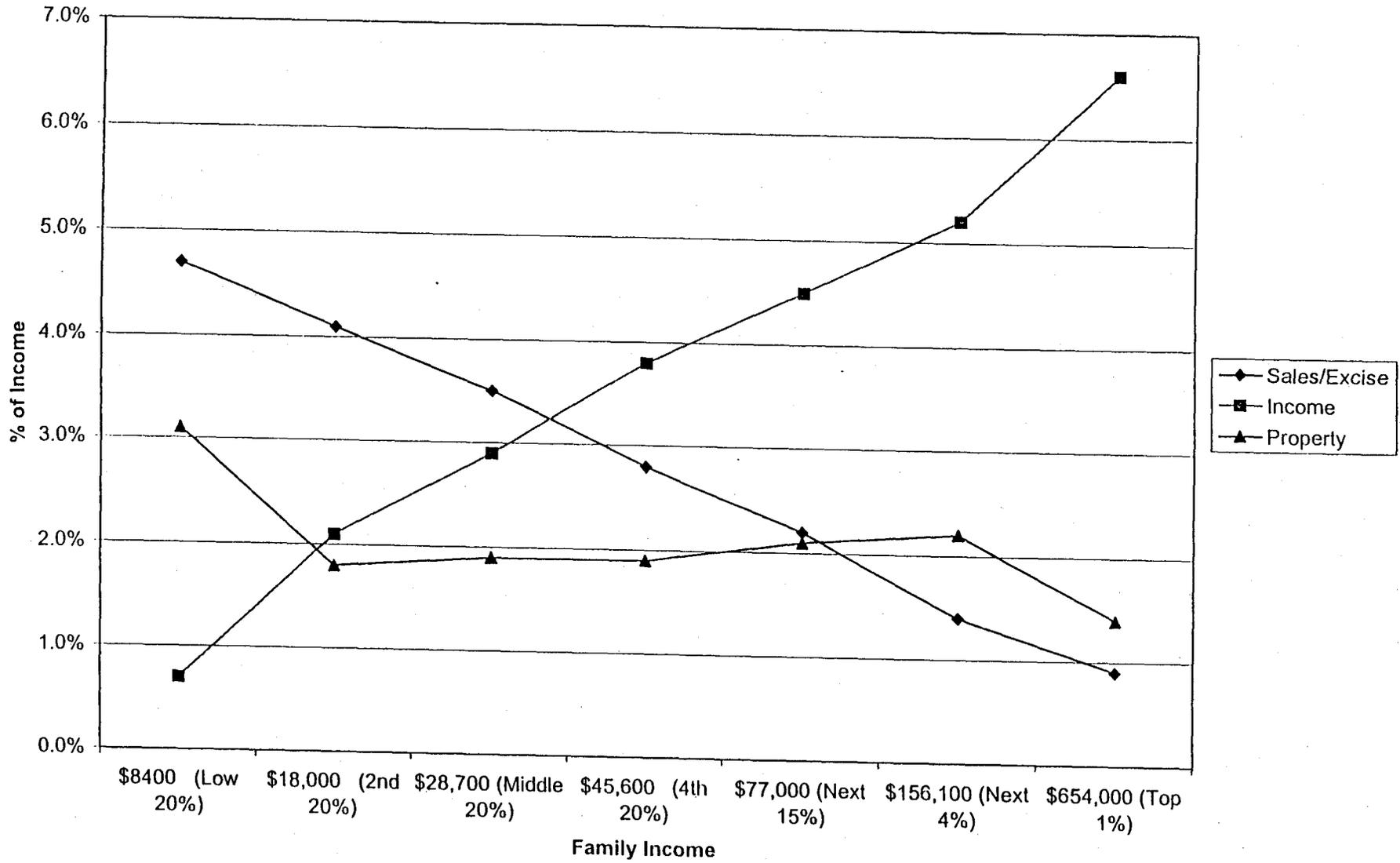
## **BIG EQUITY ISSUES**

- **Low-Income Taxpayers Pay More of Their Income in State and Local Taxes Than Do Upper-Income Taxpayers**
- **Corporate Tax Expenditures Make Code More Complicated**
- **Sales Tax Issues With What People Buy and Where They Buy It**

### North Carolina State and Local Taxes as a % of Income



Types of Taxes as a % of Income, By Income Class



## **ISSUES FOR TAX POLICY COMMISSION**

- **Use the State Income Tax To Balance the Regressivity of the Rest of the System – State Earned Income Tax Credit**
- **Keep Control on Local Taxing Authority. Investigate Use of a Circuit Breaker to Benefit Property-Rich, Income-Poor Taxpayers.**
- **Simplify the State Sales Tax Code.**
- **Simplify the State Corporate Income Tax Code.**
- **Be Mindful of Interaction with the Federal Income Tax Code.**

# State Sales Tax Rates

January 1, 2000

-----Exemptions-----

State	Tax Rates	Food	Prescription Drugs	Non-prescription Drugs
ALABAMA	4		*	
ALASKA	none			
ARIZONA	5	*	*	
ARKANSAS	4.625		*	
CALIFORNIA	6	*	*	
COLORADO	3	*	*	
CONNECTICUT	6	*	*	
DELAWARE	none			
FLORIDA	6	*	*	*
GEORGIA	4	*	*	
HAWAII	4		*	
IDAHO	5		*	
ILLINOIS (2)	6.25	1%	1%	1%
INDIANA	5	*	*	
IOWA	5	*	*	
KANSAS	4.9		*	
KENTUCKY	6	*	*	
LOUISIANA	4	3.0% (5)	*	
MAINE (4)	5.5	*	*	
MARYLAND	5	*	*	*
MASSACHUSETTS	5	*	*	
MICHIGAN	6	*	*	
MINNESOTA	6.5	*	*	*
MISSISSIPPI	7		*	
MISSOURI	4.225		*	
MONTANA	none			
NEBRASKA	5	*	*	
NEVADA	6.5	*	*	
NEW HAMPSHIRE	none			
NEW JERSEY	6	*	*	*
NEW MEXICO	5		*	
NEW YORK	4	*	*	*
NORTH				

CAROLINA	4	* (5)	*	
NORTH DAKOTA	5	*	*	
OHIO	5	*	*	
OKLAHOMA	4.5		*	
OREGON	none			
PENNSYLVANIA	6	*	*	*
RHODE ISLAND	7	*	*	*
SOUTH CAROLINA	5		*	
SOUTH DAKOTA	4		*	
TENNESSEE	6		*	
TEXAS	6.25	*	*	
UTAH	4.75		*	
VERMONT	5	*	*	*
VIRGINIA	3.5	3.0% (6)	*	*
WASHINGTON	6.5	*	*	
WEST VIRGINIA	6		*	
WISCONSIN	5	*	*	
WYOMING (3)	4		*	
DIST. OF COLUMBIA	5.75	*	*	*

---

Source: Compiled by FTA from various sources.

(1) Some state tax food, but allow an (income) tax credit to compensate poor households. They are: ID, KS, SD, VT, and WY.

(2) 1.25% of the tax in IL.

(3) Tax rate may be adjusted annually according to a formula based on balances in the unappropriated general fund and the school foundation fund.

(4) Tax rate scheduled to decrease to 5.0% on 7/1/00.

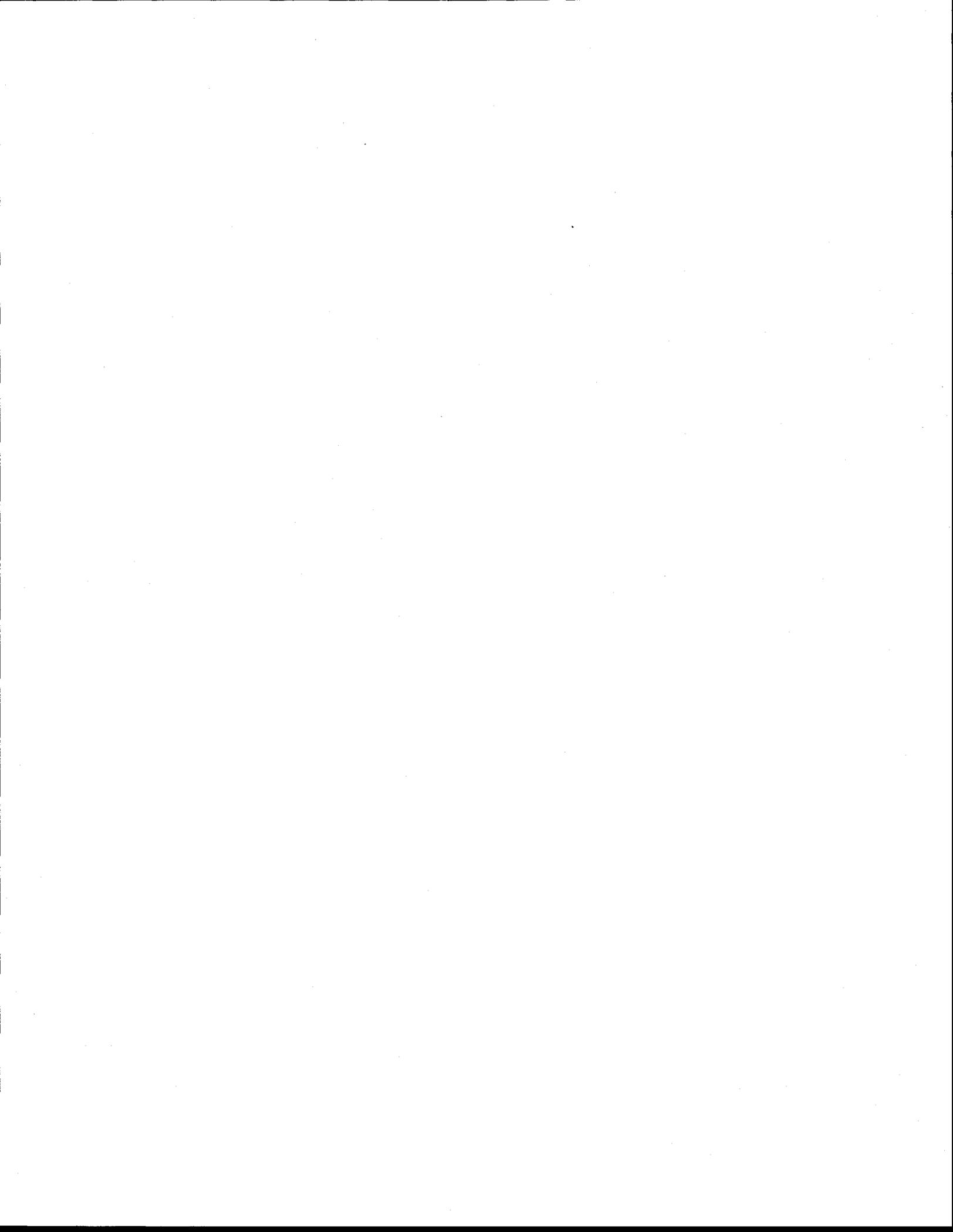
(5) Food sales are subject to local sales taxes. In LA, food sales scheduled to be exempt on 7/1/00.

(6) Tax rate on food is scheduled to decrease to 2.5% on 4/1/01.

# **EXHIBIT G**

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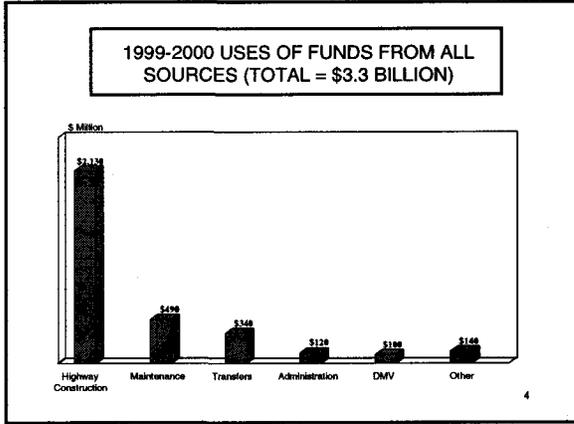
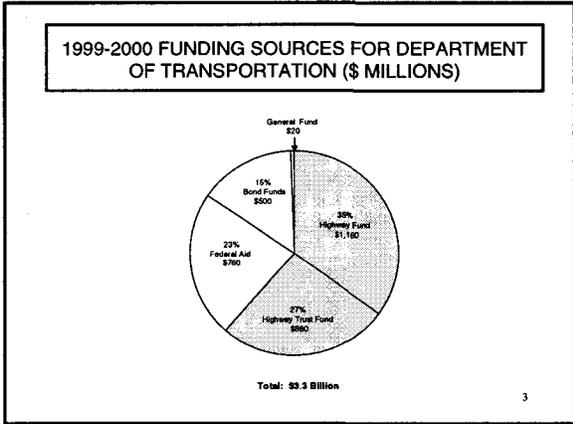
## **State Transportation Funding and Issues**



# STATE TRANSPORTATION FUNDING AND ISSUES

Fiscal Research Division, April, 2000

- ## State Transportation Funding and Issues
- Background on transportation funding
  - Maintenance
  - Construction
  - Public transportation

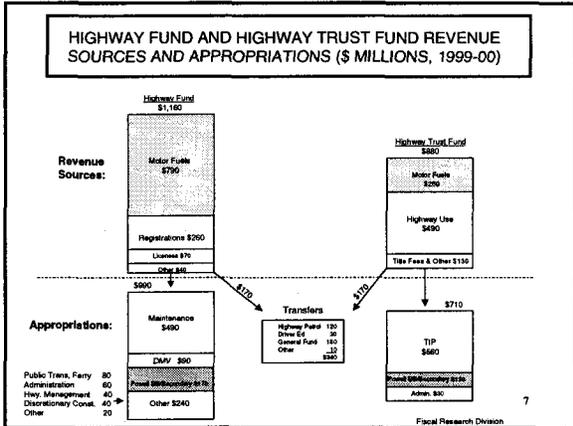


### DIFFERENCES BETWEEN HIGHWAY FUND AND HIGHWAY TRUST FUND (RULES OF THUMB)

	Highway Fund	Highway Trust Fund
Major State Revenue Source	Motor Fuels Taxes ("Gas Tax")	Highway Use Tax (3% on Motor Vehicles)
Biggest Program	Maintenance	Construction
Method of Allocation	Appropriations Process	Formulas in Statutes (G.S. 136-176)

### REVENUE GROWTH IN THE HIGHWAY FUND, HIGHWAY TRUST FUND AND GENERAL FUND

	Revenues (\$ Millions)		
	1990-91	1998-99	% Δ
Highway Fund	903	1,131	+25%
Highway Trust Fund	514	874	+70%
General Fund	7,283	12,465	+71%

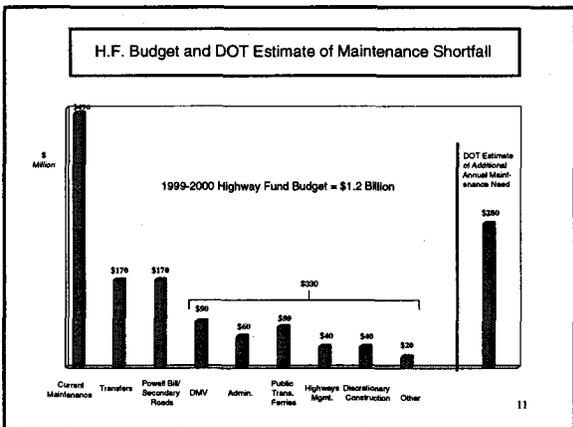
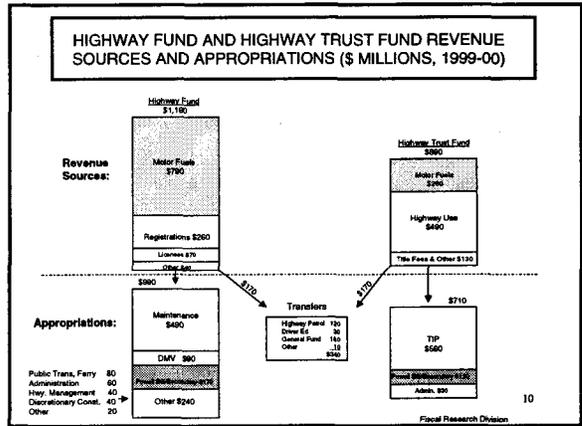


- ### HIGHWAY TRUST FUND ALLOCATION FORMULA IN G.S. 136-176 (1999-2000 BUDGET)
- \$15 of each certificate of title application fee → \$33,814,000 for Secondary Roads
  - 4.5% of remaining revenue → \$28,768,082 for Administration
  - Balance is allocated as follows:
    - 61.95% → \$401,102,481 for Intrastate Projects (TIP)
    - 25.05% → \$162,189,139 for Urban Loops (TIP)
    - 6.5% → \$42,085,006 for Powell Bill
    - 6.5% → \$42,085,006 for Secondary Roads
- 8

### MAINTENANCE SPENDING AND INDICATORS

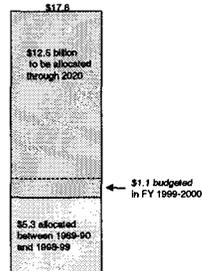
	1990	2000	% Δ
Maintenance spending (Millions, 1990 \$):	340	380	+12%
Lane Miles in Primary, Urban and Paved Secondary Systems	129,000	149,000	+16%
Vehicle Miles Driven (Millions):	63,000	92,000	+47%

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- ### HIGHWAY CONSTRUCTION DELAYS RELATED TO FUNDING
- Projects dropped from most recent 7-Year TIP
  - HTF projects originally scheduled for completion in 2003 won't be completed until 2020
  - Major Reason - projects costs higher than DOT originally estimated
    - HTF projects originally estimated at \$8.5 billion over 14 years (adjusted for inflation)
    - Most recent estimate is \$17.8 billion over 31 years (adjusted for inflation)
  - Revenues were overestimated by \$1.5 billion through 1999 (adjusted for inflation)
- 12

**ESTIMATED COSTS OF URBAN LOOPS AND INTRASTATE SYSTEM**  
(In \$ Billions, Adjusted for Inflation in Construction)



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**HIGHWAY CONSTRUCTION DELAYS - PROCESS BOTTLENECKS**

- Environmental Permitting
- Utility Relocation
- Public Involvement

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**PUBLIC TRANSPORTATION**

Potential demands on the Highway Fund budget:

- Triangle Transit Authority - \$100 million over 5 years
- Charlotte Transit Project - \$250 million over 10 years
- High Speed Rail - \$250 million over several years

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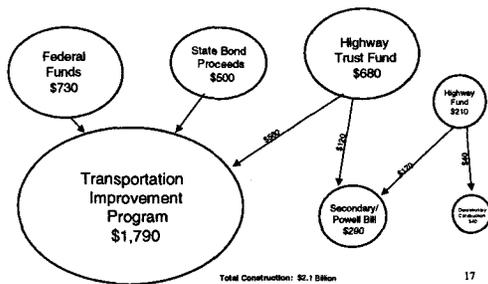
**State Transportation Funding and Issues**

- Background on transportation funding
- Maintenance
- Construction
- Public transportation

Questions?

16

**1999-2000 CONSTRUCTION FUNDS AND PROGRAMS (\$ MILLIONS)**



17

**HOW CONSTRUCTION PROJECTS ARE FUNDED**

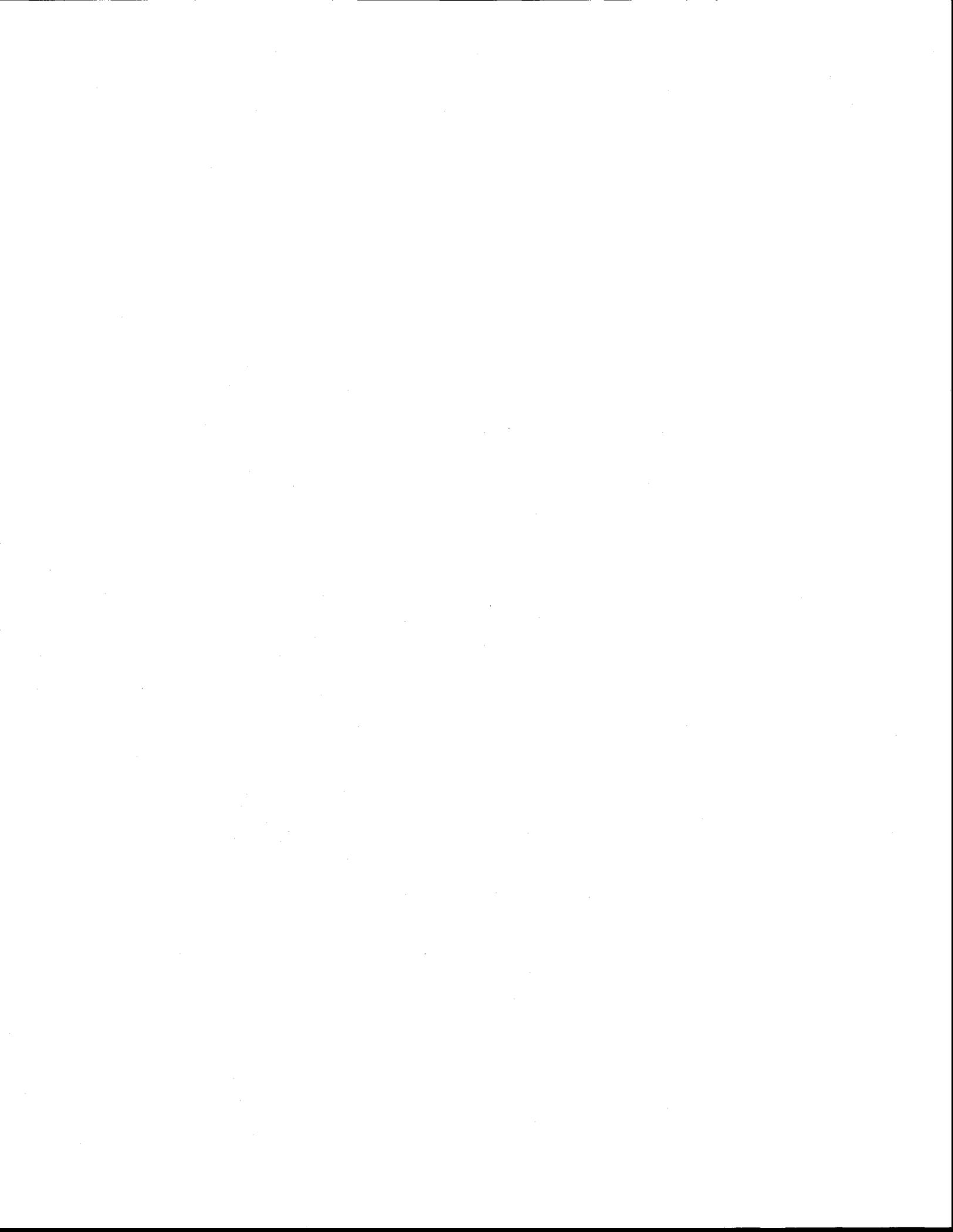
**TIP (\$1.79 Billion)** - Funding allocated by region subject to equity formula.  
 - Some projects specified by Highway Trust Fund legislation.  
 - All projects approved by Board.

**Secondary Roads (\$0.17 Billion)**  
 - Funding allocated by county based on statutory formula.  
 - County priority lists developed by DOT, approved by Board.

**Powell Bill/Aid to Municipalities (\$0.12 Billion)**  
 - Funding allocated by municipality based on statutory formula.  
 - Municipality has discretion to use subject to State standards.

**Discretionary Funds (\$0.04 Billion)**  
 - Some funding allocated by Division  
 - Projects approved by Board.

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# **EXHIBIT H**

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## **Legislative Actions and Judicial Decisions Shaping North Carolina Tax Policy**



## **TAX ACTIONS SINCE 1979**

**Richard Bostic**  
**Fiscal Research Division**

### 1979

- Response to 1979's oil shortages
  - credit for cogenerating plant
  - credit for converting boilers to wood
- Tax relief due to inflation (11.3% in 1979)
  - increased personal exemption and standard deduction
  - personal exemption unchanged since 1921

### 1979 (Continued)

- Inheritance tax law changed to help surviving spouse
  - Not substantially changed since 1913

### 1981

- Continued interest in energy alternatives
  - Tax credits for construction or installation of:
    - photovoltaic equipment facility
    - olivine brick facility
    - methane gas facility
    - wind energy device
    - hydroelectric generator
    - solar equipment for industrial heat

### 1981 (Continued)

- Energy prices affect Highway Fund
  - High fuel prices prompt shift to fuel efficient vehicles and less non essential driving
  - Lower consumption reduces gas tax revenues
    - Gas tax increased from 9¢ to 12¢ per gallon
    - Motor vehicle licenses and fees increased

### 1983

- PAC MAN introduced in 1981
  - \$15 per machine privilege tax on coin operated video games
- State rewards land conservation
  - Tax credit for land for public access to beach, public waters or trails, fish and wildlife conservation, land conservation purposes

**1983 (Continued)**

- Aid to local governments
  - Revenue to meet growing financial needs and reduce reliance on property tax
    - Half cent local sales tax
- Gift tax amended
  - Gift tax exclusion increased from \$3,000 to \$10,000

**1984**

7

**1985**

- Tax Relief
  - Inheritance tax changed to exempt surviving spouse
  - Income tax credit for taxpayers with low or moderate incomes
  - Repealed intangibles tax on money on deposit, money on hand, and funds on deposit with insurance companies

8

**1985 (Continued)**

- Exempted food purchased with food stamps from sales tax
- Increased sales tax exemption for funeral expenses from \$150 to \$1,500

**1986**

- Additional highway aid
  - Increased gas tax from 12¢ to 14¢ and a new 3% tax on average wholesale price of fuel
  - Increased aid to cities 1 3/8 to 1 3/4

9

**1987**

- Aid to schools
  - Increased corporate income tax from 6% to 7% for school facility needs and replacement of inventory tax revenue to locals
  - Repealed inventory tax
  - Eliminated merchant discount for sales tax
  - Required employers to remit withholding taxes on monthly basis

10

**1987 (Continued)**

- Aid to local government law enforcement retirement
  - Increased liquor tax from 22.5% to 28%
- Promote economic development
  - Tax credit for investment in qualified business ventures, investment organizations, and grantee businesses (\$12 million max)
  - Tax credit for employers who create jobs in severely distressed counties (\$2,800 credit)

11

**1988**

- Aid North Carolina industries
  - Changed apportionment formula to reward companies with high investment in plant and payroll in North Carolina

**1989**

- Tax Fairness and Tax Simplicity
  - Adopted federal taxable income as the starting point for calculating state taxable income

12

**1989 (Continued)**

- Reduced tax brackets from 5 to 2
- Increased personal exemption to \$2,000 (same as federal)
- Allowed joint filing of returns
- Increased standard deduction from \$550 to \$3,000 single/\$5,000 married (same as federal)
- Conformed with federal provisions such as interest deduction limits, medical expense deductions

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**1989 (Continued)**

- US Supreme Court changed tax on retirees (Davis v Michigan Department of Treasury)
  - \$4,000 exclusion for all government pensions and \$2,000 for private pensions
- North Carolina Highway Trust Fund
  - Replaced 2% sales tax on motor vehicles with 3% highway use tax on vehicle sales

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**1989 (Continued)**

- Increased gas tax from 14¢ plus 3% on wholesale price to 17¢ plus greater of 7% of wholesale price or 3.5¢
- Increased title fees
- Tax on illegal drugs
  - Tax stamps on controlled substances
  - Class I Felony if drugs without stamps

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**1989 (Continued)**

- Tax Amnesty
  - Amnesty period September to December 1989
  - Increased tax evasion penalties
  - Additional personnel

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**1991**

- Budget Deficit
  - Increased sales tax from 3% to 4%
  - Increased corporate income tax from 7% to 7 3/4%
  - Added temporary corporate income tax surcharge phased down from 4% in 1991 to 1% in 1994
  - Added 7 3/4% personal income tax rate
  - Increased cigarette tax from 2¢ to 5¢ per pack
  - Levied 2% tax on other tobacco products

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**1992**

- Aid State ports
  - Tax credit for wharfage and handling charges on exports at Wilmington and Morehead City ports
- Aid historic preservation
  - Tax credit equal to 1/4 of federal income tax credit

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**1992 (Continued)**

- Economic development
  - Extended tax credit for creating jobs from 33 counties to 50 counties
  - Unemployment tax reduced 30% for employers with a credit balance

**1994**

- Aid businesses
  - Reduced unemployment insurance tax from 2.25% to 1.8%

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**1995**

- Tax relief for lower and middle income taxpayers
  - Increased personal exemption by \$500 over two years (temporarily equal to federal)
  - \$60 credit for dependent children
- Reduce motor fuel tax evasion
  - Moved collection of tax from retail station to the terminal rack
  - Increased motor carrier enforcement

20

**1995 (Continued)**

- Intangibles Tax repealed
  - State reimbursed local governments
- Unemployment insurance tax cut again - by 23%

21

**1996**

- Incentives for High Quality Jobs and Business Expansion (Bill Lee Act)
  - Expanded jobs credit to 100 counties (5 tiers)
  - Worker training credit
  - Research and development credit
  - Credit for investment in machinery and equipment
  - Credit for investing in tangible personal property
  - Corporate income tax rate reduced from 7 3/4% to 6.9% over 4 years

22

**1996 (Continued)**

- Reduced food tax from 4% to 3%
- Created nonitemizer tax credit for charitable giving (2.75%)
- Phased out soft drink tax
- Repealed most state privilege taxes

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**1996 Continued**

- Unconstitutional taxes repealed
  - \$15,000 corporate income tax deduction for dividends received from North Carolina companies
  - \$300 individual income tax credit for dividends received from North Carolina companies
  - Tax credits for investing in qualified business investments in North Carolina companies
  - Tax credit for distributing North Carolina wine

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**1997**

- Courts rule in *Fulton Corporation v Faulkner*
  - Refunds to taxpayer who paid intangibles tax under protest
- State food tax lowered to 2%
- Created a dry cleaning solvent tax to cleanup contaminated sites

25

**1997 (Continued)**

- Help movie and TV industry
  - Exempted audiovisual master tape from sales tax
- Economic development incentives
  - Expanded Bill Lee Act to aid air courier services and central administrative offices
  - Extended state ports credit to 2001

26

**1997 (Continued)**

- Aid historic preservation
  - Expanded tax credit for income producing structures from 5% to 20%
  - Created new 20% tax credit for non-income producing

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**1998**

- Economic development incentives
  - Tax credit for major recycling facilities
  - Allowed tax credit against insurance gross premiums tax
  - Expanded the credit for research and development (1/4 of federal)
  - Increased tax credits for firms locating in state development zones

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**1998 (Continued)**

- Tax credits to aid interstate air courier such as Fed Ex
- Extended credit for qualified business investment until 2003
- Aid to individuals
  - Tax credit for the purchase of child health insurance

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**1998 (Continued)**

- Tax credit for the purchase of long term care insurance
- Repealed final 2% food tax
- Repealed inheritance tax - establish estate tax
- Changed tax on piped natural gas to tax based on therms

30

**1998 (Continued)**

- Courts rule again
  - Exempted state, federal, local pensions from income tax

**1999**

- Economic development incentives
  - Bill Lee Act amended to aid air carrier training centers, TIAA-CREF, electronic mail order houses
  - Extended Bill Lee Act from 2002 to 2006

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• **1999 (Continued)**

- Created affordable housing tax credit
- New tax credit for commercial use of university technology
- New tax credit for manufacturing cigarettes for export

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**1999 (Continued)**

- Improve use tax collection
  - Report use tax on income tax form
  - Prohibit state agencies from contracting with vendor who fails to collect sales tax
- Repealed several energy credits and replaced with renewable energy credit
- Pay intangible tax nonprotestors

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# General Fund Tax Expenditures

Richard Bostic  
Fiscal Research Division

## What is a tax expenditure?

- Term coined in the U.S. Treasury Department in 1968
- Recognize that the tax system is also an instrument for government spending
- A law that lowers a citizen's tax liability has no different affect than a law that requires a direct payment to the citizen.

## What is a tax expenditure in North Carolina?

According to G.S. 105-256(2):

- Credit
- Refund
- Allowance
- Preferential tax rate
- Deduction
- Exemption
- Exclusion
- Device that reduces the amount of tax revenue that would otherwise be available to the state

## Who is to report on tax expenditures?

- Secretary of Revenue is to publish a list of tax expenditures every 2 years.
- Last Biennial Tax Expenditure Report was issued October 1, 1992.
- Four new positions appropriated to Tax Research Division in Department of Revenue in FY 99-00

## What is document in notebook?

- Brief overview of tax expenditures in General Fund
- Fiscal estimates for FY 99-00, except when noted
- Some estimates based on Department of Revenue projections in 1992 and inflated to 1999
- Actual data used when available

## What is the fiscal impact on the General Fund of tax expenditures?

- A minimum annual revenue loss of \$1.9 billion to \$2.2 billion
- Some tax expenditures have not been estimated.

### Sales and Use Tax

- Rates from 1% to 6.5%
- Caps from \$80 on machinery to \$1,500 on boats
- 59 exemptions; major exemption is food
- 3 refund provisions for economic development
- Refunds for nonprofits; public schools
- Total annual cost to General Fund equals \$1 billion to \$1.2 billion

### Individual Income Tax

- 16 tax credits
- Exclusion for social security payments
- Partial exclusion for severance pay and pension income
- Total annual cost to General Fund equals \$376.1 million to \$396.1 million

### Corporate and Individual Income Tax

- 12 tax credits
- William S. Lee Act plus other business incentives
- Annual General Fund impact equals \$179.6 million by FY 05-06

### Corporate Income Tax

- Apportionment formula weighted to sales
- 13 tax credits
- S corporations avoid corporate tax
- Deductions for subsidiary dividends
- Bank deduction for expenses incurred to earn tax exempt income
- Some income not taxed anywhere (nexus, throwback rule)
- Annual General Fund impact equals \$304.4 to \$317.4 million

### Privilege Tax

- Amusements taxed at 3%
- Movies taxed at 1%
- Raise tax on both to 4% = \$9.1 million/year

### Tobacco Products Tax

- Exemption for sample cigarettes, nonresident wholesalers, out of state shipments, cigarette manufacturer employees
- Distributor discounts
- Other tobacco products taxed at 2%
- Total impact unknown, \$4.5 million annual loss estimated

### Alcoholic Beverage License and Excise Taxes

- Distributor discount for beer and wine
- 5 exemptions
- Lower tax rate for unfortified wine
- Total impact unknown, \$4.4 annual million loss estimated

### Insurance Premium Tax

- HMOs exempt
- Blue Cross pays .05% not 1.9%
- Tax credit for payments to Guaranty Associations
- Annual impact is \$35.7 to \$50.1 million

### Points to Consider

- Review tax expenditures to determine whether provision would be better administered as direct spending program
- Assign agencies to review tax expenditures in their program areas
- Require greater disclosure by companies receiving tax expenditures
- Require Department of Revenue to gather and tabulate more information on tax expenditures



# North Carolina General Fund Tax Expenditures

Prepared by  
Fiscal Research Division

- **What is a tax expenditure?**

G.S. 105-256(2) defines a tax expenditure as "an exemption, an exclusion, a deduction, an allowance, a credit, a refund, a preferential tax rate, or another device that reduces the amount of tax revenue that would otherwise be available to the state."

- **Who is to report on tax expenditures?**

In G.S. 105-256(2), the General Assembly mandated the Secretary of Revenue to publish a list of tax expenditures at least every two years. The last Biennial Tax Expenditure Report was issued on October 1, 1992. The Tax Research Division of the Department of Revenue was appropriated funds in the 1999 Session to hire four researchers in FY 99-00 to work on this and other required reports. These positions have not yet been hired.

- **What is this document?**

This document provides a brief overview of the tax expenditures or tax preferences in the General Fund. Fiscal estimates are for FY 99-00, except when noted. Some estimates are based on Department of Revenue projections in 1992 and inflated to 1999. Actual data is used when available.

## NC TAX EXPENDITURES (\$ MILLION)

GS 105	Description	Current Law	Options	Fiscal Effect 99-00
<b>SALES &amp; USE TAX - Rates</b>				
164.3(16)(f)	Vending machines	Currently sales tax on sales made through vending machine are reduced by 50% (except closed container soft drinks and tobacco products)	Tax vending machine sales at 100%.	NA
164.4a(1a)	Manufactured homes	2%, \$300 limit	3%, no limit	NA
164.4a(1b)	Boats, aircraft, railway cars, locomotives	3%, \$1,500 limit	3%, no limit	10.5
164.4a(1c)	Fuel sold to farmers, cleaners, manufacturing industries; horses, animal semen, freeze lockers, plants supplies	1%	4%	NA
164.4a(1d) & 164.4A	Manufacturing machinery, farm machinery, etc.	1%, \$80 limit	1%, \$280 limit 1%, \$700 limit 1%, no limit 2%, \$240 limit 3%, no limit 4%, no limit	2.1 5.5 21.0 39.4 132.0 178.5
164.4a(1e)	Mobile office or mobile classroom sold at retail	3%, \$1,500 limit	3%, no limit	NA
164.4a(1f)	Electricity and piped natural gas to farmers, manufacturers, and commercial laundries and cleaners	2.83%	3%	5.9
164.4a(4a)	Coin Calls from Pay Telephones	Exempt from 3% tax	Reinstate 3% tax	1.9
164.4a(4c)	Interstate telecommunications	Exempt	6.5% (intrastate rate)	55.6
164.4A(12)	Passenger air carriers & air couriers - flight crew training simulators at hub	1%, \$80 limit	4%	0.4
<b>SALES &amp; USE TAX - Exemptions</b>				
<b>Agricultural Group</b>				
164.13 (1)	Commercial fertilizer	Exempt	4%	6.8
164.13 (2) & 2(a)	Seeds, vaccines, feed	Exempt	4%	28.0
164.13 (3)	Forest, mining products sold by original producer	Exempt	4%	NA
164.13(4)	Cotton, tobacco, peanuts or other farm products sold to manufacturers for further manufacturing or processing	Exempt	4%	NA
164.13(4a)	Baby chicks and poults for commercial poultry or egg production	Exempt	4%	NA
164.13(4b)	Farm products sold by farmer	Exempt	4%	0.9
164.13(4c)	Swine, livestock, poultry production equipment	Exempt	4%	2.2
164.13(4d)	Tobacco sheets	Exempt	4%	NA

GS 105	Description	Current Law	Options	Fiscal Effect 99-00
<b>Industrial Group</b>				
164.13(5)	Manufactured products produced and sold to other manufacturers for the purpose of resale	Exempt	4%	NA
164.13(7)	Seafood sold in original unmanufactured condition	Exempt	4%	2.5
164.13(8)	Tangible personal property sold to manufacturer and becomes component of manufactured product.	Exempt	4%	NA
164.13(8a)	Sale of fuel to small power production facility	Exempt	4%	NA
164.13(9)	Boats and fishing supplies sold to commercial fishermen	Exempt	4%	NA
164.13(10)	Laundry and dry cleaning supplies sold to commercial laundries	Exempt	4%	0.3
<b>Motor Fuels Group</b>				
164.13(10a)	Sales of lubricants, materials, parts and supplies to major recycling facility	Exempt	4%	
164.13(10b)	Sales of electricity to major recycling facility	Exempt	4%	0.07
164.13(11a)	Sale of diesel fuel to railroad companies for use in rolling stock	Exempt	4%	NA
<b>Medical Group</b>				
164.13(12 & 13)	Prescription medicine and medical devices	Exempt	4%	64.3
<b>Printed Materials Group</b>				
164.13(14)	Public school books	Exempt	4%	
164.13(14a)	Printed materials sold out-of-state	Exempt	4%	10.9
<b>Transactions Group</b>				
164.13(15)	Items that are taxed, then considered worthless and charged off against income tax.	Exempt	4%	NA
164.13(16)	Items repossessed by vendor if tax paid on sales price of article	Exempt	4%	NA
<b>Exempt Status Group</b>				
164.13(17)	Sales prohibited from taxation by the state or US constitutions.	Exempt	4%	NA

GS 105	Description	Current Law	Options	Fiscal Effect 99-00
<b>Unclassified Group</b>				
164.13(18)	Funeral expenses	First \$1500 is exempt	Repeal exemption	4.2
164.13(20)	Blind merchant sales	Exempt	4%	0.2
164.13(21)	Lease of films for exhibition	Exempt	4%	2.3
164.13(22)	Lease of films to radio and television stations	Exempt	4%	Insignificant
164.13(22a)	Audiovisual masters	Exempt	4%	1.7
164.13(23)	Packaging materials	Exempt	4%	
164.13(24)	Fuel to ocean vessels	Exempt	4%	0.2
164.13(25)	Sales by merchants on the Cherokee Indian Reservation	Exempt	4%	NA
164.13(26)	Public school breakfasts & lunches	Exempt	4%	5.0
164.13(26a)	Food sold by school to child care center that participates in DPI food program	Exempt	4%	NA
164.13(27)	College dining room food	Exempt	4%	3.2
164.13(28)	Newspapers and magazines sold by street vendors and door-to-door	Exempt	4%	4.4
164.13(29)	N.C. Museum of Art purchases from donated funds	Exempt	4%	Insignificant
164.13(30)	Sales from vending machines with items valued at 1 cent per sale	Exempt	4%	Insignificant
164.13(31)	Meals-on-Wheels meals	Exempt	4%	NA
164.13(31a)	Food sales by nonprofit religious groups when proceeds used for religious purposes	Exempt	4%	Insignificant
164.13(32)	Motor vehicle body mounted on chassis that is not titled	Exempt	4%	NA
164.13(33)	Export sales	Exempt	4%	0.2
164.13(34)	Nonprofit sales to benefit the state or state agencies	Exempt	4%	NA
164.13(35)	Sales during annual fundraising drives by nonprofit groups	Exempt	4%	NA
164.13(36)	Newspaper advertising inserts	Exempt	4%	1.1
164.13(37)	Liquor	Exempt, but subject to excise tax		
164.13(38)	Food purchased with food stamps	Exempt	4%	30.0
164.13(40)	Sales to the Department of Transportation	Exempt, but DOT pays \$13.6 million to General Fund in lieu of tax		
164.13(41)	Sales of mobile classrooms to local school boards	Exempt	4%	NA
164.13(42)	Inventory donated to nonprofit organization or government entity	Exempt	4%	0.6
164.13(43)	Custom computer software	Exempt	4%	5.2

GS 105	Description	Current Law	Options	Fiscal Effect 99-00
164.13(44)	Piped natural gas	Exempt, but excise tax imposed under Article 5E		
164.13(45)	Sales to air courier hubs (1/1/2001)	Exempt	4%	0.04
164.13(45)	Passenger air carriers	Exempt aircraft lubricants, parts, and accessories for use at its hub	4%	1.2
164.13B	Food for home consumption	Exempt (still subject to 2% local sales tax)	4%	369.0
164.4	Cable TV	Exempt	4%	15.1
164.4	Services:			
	Professional	Exempt	4%	201.5
	Nonprofessional	Exempt	4%	86.4
164.4(a)(4)	Receipts from coin-operated washing machines	Exempt	4%	2.3
37.1	Bingo	Exempt	4%	1.4
<b>SALES &amp; USE TAX - Refunds</b>				
164.14(b)(1-3)	Nonprofit educational institutions, churches, hospitals, charities	Refund	4%	101.7
164.14(b)(4)	Nonprofit retirement homes	Refund	4%	5.1
164.14(c)	Local governmental entities	Refund	4%	19.4
164.14(c)(20)	UNC System expenditure of contract and grant funds	Refund	4%	NA
164.14(c)(21)	N.C. Memorial Hospital	Refund	4%	1.9
164.14(g)	Major recycling facility - building materials, supplies, and fixtures	Refund	4%	1.3 (one-time)
164.14(h)	Machinery & equipment for firms in Tier 1 and 2 counties	Refund	4%	0.1
164.14(i)	Nonprofit insurance companies - materials, supplies, fixtures, and computer	Refund for 8 years (4 years for computer equipment)	4%	1.2
<b>Sales and Use Tax Total Impact</b>				
				Range = \$1,057.8 to \$1,235.5
<b>INDIVIDUAL INCOME TAX</b>				
129.35-37	Historic Structure Rehabilitation	Tax credit is equal to 20% of the expenditures that qualify for a federal credit on income producing, certified historic structures. Another tax credit is equal to 30% of the rehabilitation expenses of a non income producing, certified historic structure. The expenditures for the non income producing project must exceed \$25,000 within two year period.	Repeal the credit	Included in corporate estimate
134.6(b)(3)	Social Security Benefits	The state grants full exclusion of Social Security payments from state income tax. The federal government taxes 85% of payments above \$34,000 or \$44,000 if married filing jointly.	Conform to Federal Taxation of Social Security	85.3
134.6(b)(6)	Retirement income	Retirement income exclusion of \$4,000 for public and \$2,000 for private retirees	No exclusion	80-100

GS 105	Description	Current Law	Options	Fiscal Effect 99-00
134.6(b)(11)	Severance Pay	Currently \$35,000 of severance pay is excluded from income tax.	Repeal the exclusion.	6.1
151.1	Handicapped dwelling units	Tax credit is equal to \$550 for each dwelling unit constructed for handicapped persons in multifamily rental units.	Repeal the credit	NA
151.6	Construction of fuel ethanol distillery	Tax credit is equal to 20% of the installation and construction cost of a distillery to make ethanol from agricultural or forestry products. An additional 10% credit is given if the distillery is powered by an alternative fuel source.	Repeal the credit	2.5 is max allowed
151.11	Child-care and employment related expenses	Tax credit is equal to a percentage of employment related expenses relating to child care and is based on adjusted gross income, filing status, and age of child	Repeal the credit	21.7
151.12	Certain real property donations	Tax credit is equal to 25% of the fair market value of property donated for public use. The credit must not exceed \$250,000 and has a five year carryforward. DENR must certify that donated land is suitable.	Repeal the credit	Included in corporate estimate
151.13	Conservation tillage equipment	Tax credit is equal to 25% of the cost of the conservation tillage equipment purchased for use in a farming business. Maximum credit is \$2,500 with a five year carryforward.	Repeal the credit	NA
151.14	Gleaned crop	Tax credit is equal to 10% of the market price of the quantity of the gleaned crop.	Repeal the credit	NA
151.18	Disabled taxpayers	Tax credit is equal to one third of the federal income tax credit for the disabled. For disabled dependents, the credit is based on adjusted gross income and filing status	Repeal the credit	0.2
151.21	Property taxes paid on farm machinery	Tax credit is equal to amount of property tax paid on farm machinery, attachments and repair parts. The credit cannot exceed \$1,000.	Repeal the credit	NA
151.22	North Carolina State Ports Authority wharfage, handling, and throughput charges	Tax credit is equal to the excess of the wharfage, handling, and throughput charges assessed on the cargo in current year as compared to the two previous years. The credit is limited to 50% of the income tax liability and has a maximum cumulative amount of \$2 million.	Repeal the credit	Included in corporate estimate
151.24	Dependent Child	Tax credit equal to \$60 for each dependent child. The credit is subject to income caps based on AGI.	Repeal the credit	89.2
151.25	Poultry Composting Facility	Tax credit is equal to 25% of the installation, materials, and equipment cost of construction. Credit limited to \$1000 per installation.	Repeal the credit	Included in corporate estimate

GS 105	Description	Current Law	Options	Fiscal Effect 99-00
151.26	Non-itemizer Charitable Contributions	This is a 7% tax credit for charitable contributions made by individuals who do not itemize their deductions. The credit is for contributions that exceed 2% of the taxpayer's AGI.	Repeal the credit	12.6
151.27	Child Health Insurance	Effective Tax Year 1999, this credit is equal to the amount of health insurance premium paid by taxpayer with cap of \$300 for taxpayers with adjusted gross income (AGI) under 225% of federal poverty level and \$100 for taxpayers with AGI exceeding 225% of federal pov. level. Credit subject to income caps based on AGI.	Repeal the credit.	64.5
151.28	Long Term Care Insurance	Effective Tax Year 1999, this credit is equal to 15% of the premium paid each year on long term care insurance. The credit may not exceed \$350 per policy.	Repeal the credit	8.0
163.010 to 163.014	Qualified Business Investments	This credit is equal to 25% of the amount invested in a qualified business venture or a qualified grantee business. The credit may not exceed \$50,000 per individual per tax year.	Repeal the credit (set to expire in 2003)	6.0 Max.
<b>Individual Income Tax Total Impact</b>				<b>Range = \$376.1 to \$396.1</b>
<b>CORPORATE AND INDIVIDUAL INCOME TAX</b>				
129.8	Job creation	Tax credit for each full-time job created is based on enterprise tier development zone designation. Credit ranges from \$500 to \$12,500 per job.	Repeal the credit	20.1 FY 04-05
129.9	Machinery & equipment	Tax credit is equal to 7% of the excess eligible investment over a threshold based on enterprise tier and development zone designation. The investment threshold ranges from 0 in tier 1 and development zones to \$1 million in tier 5.	Repeal the credit	108.7 FY 04-05
129.9A	Technology commercialization	Tax credit is equal to 20% of the excess eligible investment in a Tier 1, 2, or 3 county; must invest at least \$10 million in taxable year and \$150 million over 5 years. Credit reduced to 15% if investment below \$150 million.	Repeal the credit	2.1
129.10	Research and development	A. General credit is allowable for 5% of the increase in research and development expenses attributable to North Carolina. Must claim a federal income tax credit for research and meet other requirements. B. Alternative credit is equal to 25% of the state's apportioned share of the federal alternative credit.	Repeal the credit	9.1
129.11	Worker training	Tax credit for training five or more employees is equal to \$1000 per employee in Tier 1 counties and development zone and \$500 per employee in other counties.	Repeal the credit	1.7

GS 105	Description	Current Law	Options	Fiscal Effect 99-00
129.12	Central administrative office property	Tax credit is equal to 7% of the excess eligible investment amount up to \$500,000. Credit must be taken over 7 years. Firm must hire 40 new workers and must meet Commerce wage standard.	Repeal the credit	6.8 FY 05-06
129.13	Development zone projects	Tax credit is equal to 25% of the contribution in cash or property to a development zone agency. There is a \$4 million cumulative maximum each year on credits.	Repeal the credit	4.0 FY 02-03
129.16	Business property	Tax credit is equal to 4.5% of the cost of business property that a taxpayer purchased or leased and placed in service in NC during taxable year. Maximum credit is \$4500 and is taken over 5 years.	Repeal the credit	16.9
129.16A	Renewable energy property	Tax credit equal to 35% of the cost of the renewable energy property constructed, purchased, or leased by a taxpayer. If used in single family residence, take in one year. Otherwise must be taken in five equal installments.	Repeal the credit	NA
129.16B	Low-income housing	Tax credit based on federal credit for rehabilitating or constructing affordable housing. For tier 1 and 2 counties, the credit is 75% of the federal credit. For other counties, the credit is 25% of the federal credit. The credit is taken in five equal installments.	Repeal the credit	1.5 FY 01-02
129.27	Large or major recycling facility	Major- credit equal to 50% of the amount to purchase or lease machinery and equipment. Large - credit equal to 20% of the amount to purchase or lease machinery and equipment.	Repeal the credit	0.6
129.28	Recycling facility transport expenses	Tax credit equal to additional transportation and transloading expenses	Repeal the credit	8.1 FY 01-02
<b>Corporate and Individual Income Tax Total Impact</b>				<b>\$179.6</b>
<b>CORPORATE INCOME TAX</b>				
130.4	Apportionment Formula	Apportionment of corporate income is now based on a double weighted sales factor - sales (1/2), payroll (1/4), and property (1/4).	Convert to equal weighted factors - sales (1/3), payroll (1/3), and property (1/3).	56.1
130.5(a)(2)	Bank Expenses	State domiciled financial institutions receive a deduction for expenses incurred to earn tax exempt income.	Repeal the deduction	\$54 to \$70 *
130.7	Subsidiary dividends	A corporation can deduct all dividends received from corporations in which it owns more than 50% of the outstanding voting stock.	Require 15% of related expenses to be netted from dividends before the dividends are deducted.	30.0
130.22	Handicapped dwelling units	Tax credit is equal to \$550 for each dwelling unit required by the building code to be constructed for handicapped persons in multifamily rental units.	Repeal the credit	NA

GS 105	Description	Current Law	Options	Fiscal Effect 99-00
130.25	Construction of cogenerating plant	Tax credit is equal to 10% of the cost of the purchase and installation of the electrical and mechanical power generating equipment of a cogenerating plant.	Repeal the credit	0.5
130.27	Ethanol fuel distillery	Tax credit is equal to 20% of the installation and construction cost of a distillery to make ethanol from agricultural or forestry products. An additional 10% credit is given if the distillery is powered by an alternative fuel source.	Repeal the credit	2.5 is max allowed
130.28	Photovoltaic equipment facility	Tax credit is equal to 25% of the installation and construction cost of a photovoltaic equipment facility.	Repeal the credit	NA
130.34	Certain real property donations	Tax credit is equal to 25% of the fair market value of property donated for public use. The credit must not exceed \$500,000 and has a five year carryforward. DENR must certify that donated land is suitable.	Repeal the credit	4.2
130.36	Conservation tillage equipment	Tax credit is equal to 25% of the cost of the conservation tillage equipment purchased for use in a farming business. Maximum credit is \$2,500 with a five year carryforward.	Repeal the credit	NA
130.37	Gleaned crop	Tax credit is equal to 10% of the market price of the quantity of the gleaned crop.	Repeal the credit	5.5
130.39	Telephone subscriber line charges	Tax credit is the difference between what the local telephone service provider could have charged and what was actually charged the low-income customer.	Repeal the credit	0.5
130.41	North Carolina State Ports Authority wharfage, handling, and throughput charges	Tax credit is equal to the excess of the wharfage, handling, and throughput charges assessed on the cargo in current year as compared to the two previous years. The credit is limited to 50% of the income tax liability and has a maximum cumulative amount of \$2 million.	Repeal the credit	3.6
130.42	Historic Structure Rehabilitation	Tax credit is equal to 20% of the expenditures that qualify for a federal credit on income producing, certified historic structures. Another tax credit is equal to 30% of the rehabilitation expenses of a non income producing, certified historic structure. The expenditures for the non income producing project must exceed \$25,000 within two year period.	Repeal the credit	3.8
130.43	Savings and loan supervisory fees	Tax credit to savings and loan association equal to the amount of fees charged by the Department of Commerce.	Repeal the credit	0.1

GS 105	Description	Current Law	Options	Fiscal Effect 99-00
130.44	Poultry Composting Facility	Tax credit is equal to 25% of the installation, materials, and equipment cost of construction. Credit limited to \$1000 per installation.	Repeal the credit	0.03
130.45	Manufacturing cigarettes for export	Tax credit is based on the increase in volume of cigarettes exported over the amount exported in 1998. A taxpayer is limited to \$6 million in credit.	Repeal the credit	8.7
130.4	Corporate Nexus	Currently credit card companies do business in North Carolina, but pay no income tax, if they do not have a "physical presence" in the state. (Note: The Department of Revenue asserts nexus to companies which use intangibles in this state and also to mortgage lenders with more than \$5 million of loans secured by real estate in this state.)	Provide that nexus may be based on a substantial customer base. This would result in the taxation of several out of state credit card companies	45.9
130.4	Corporate Throwback Rule	Some out-of-state sales of multistate corporations escape all state taxation.	Establish Corporate Income Tax Throwback Rule. Under this provision, these "nowhere sales" would be thrown back and taxed in North Carolina.	NA
131.1	S Corporation	No tax paid by corporation - income and losses go to shareholders	3% corporate tax (California law)	70.0
130.8	Net economic loss	Corporate income tax carry forward for net economic loss is 15 years.	Return carry forward of loss to 5 years as it was prior to 1998.	16.0
<b>Corporate Income Tax Total Impact</b>				<b>Range= \$301.4 to \$317.4</b>
<b>PRIVILEGE TAX / GROSS RECEIPTS</b>				
37.1	Amusements	A 3% tax is imposed on the gross receipts from admissions to event.	A. Increase the tax from 3% to 4%. Previously, this tax was direct B. Increase the tax from 3% to 6%.	2.8 8.5
38	Movies	Effective October 1, 1998, movie gross receipts were taxed at 1% while other amusements are taxed at 3%.	A. Increase the tax from 1% to 3%. B. Increase the tax from 1% to 4%. C. Increase the tax from 1% to 6%.	4.2 6.3 10.5
<b>Privilege Tax/Gross Receipts Total Impact</b>				<b>Range = \$7 to \$19</b>
<b>TOBACCO PRODUCTS TAX</b>				
113.5 (1)	Sample cigarettes	Tax exemption for sample cigarettes in packages containing five or fewer cigarettes for free distribution.	No exemption	NA
113.5 (2)	Cigarettes given to employees of cigarette manufacturer	Tax exemption for cigarettes in packages given to factory employees of cigarette manufacturers	No exemption	NA
113.9	Out of state shipments	Tax exemption for non tax paid cigarettes shipped outside the state by licensed NC distributors.	No exemption	NA
113.9	Nonresident wholesaler or retailer	Tax exemption for sales to nonresident wholesaler or retailer registered with Revenue but with no place of business in NC	No exemption	NA

GS 105	Description	Current Law	Options	Fiscal Effect 99-00
113.21	Cigarette distributor discount	Currently distributors can deduct 4% from their excise tax liability to compensate for administering the tax.	Repeal 4% discount.	1.9
113.35	Other tobacco products tax	Tax exemption for other tobacco products sold outside the state, sold to the federal government, or distributed as free samples.	Tax at 2% as "other tobacco products"	NA
113.35	Other tobacco products tax	"Other Tobacco Products" are taxed at 2% of the cost price of the product.	Increase the rate to 4%.	2.9
113.39	Other tobacco product distributor discount	Currently distributors can deduct 4% from their excise tax liability to compensate for administering the tax.	Repeal 4% discount.	NA
<b>Tobacco Products Tax Total Impact</b>				<b>4.8</b>
<b>ALCOHOLIC BEVERAGE LICENSE &amp; EXCISE TAXES</b>				
113.80(b)	Wine	Tax is 21 cents per liter on unfortified wine and 24 cents per liter on fortified wine.	Tax both at 24 cents per liter	NA
113.81	Exemptions	Tax exemptions for 1) product made unsalable due to major disaster, 2) sale to oceangoing vessels, 3) sales to Armed Forces, 4) out-of-state sales, and 5) tasting at breweries and wineries.	Repeal exemptions	NA
113.85	Beer and Wine Distributor Discount	Distributors can deduct 4% from their excise tax payment to compensate for administering the tax and for spoilage and breakage.	Repeal 4% discount.	4.39*
113.87	Sacramental wine	Tax refund for wine used for sacramental purposes	Repeal refund	NA
<b>Alcoholic Beverage License &amp; Excise Taxes Total Impact</b>				<b>4.39</b>

\* These estimates are based on old data and will be revised as newer data becomes available."

<b>TAXES UPON INSURANCE COMPANIES</b>				
228.5	HMOs	HMOs pay Income and Franchise Taxes, not Gross Premiums Tax.	Exempt HMOs from Income and Franchise Taxes, but levy a Gross Premiums Tax. Most insurance companies now pay a Gross Premiums Tax of 1.9%. Blue Cross pays at 0.05%. The estimate range reflects these options.	5.1 - 19.5
228.5	Article 65 corporations	Blue Cross Blue Shield and Delta Dental Plan pay .05% tax	Charge 1.9%, same as other insurance contracts	16.5
228.5A	Guaranty Fund Tax Credit	Insurance Companies receive a 100% credit for their assessments paid to NC Insurance Guaranty Association and NC Life and Health Insurance Association. The credit is taken over 5 years.	Repeal the credit	14.1
<b>Taxes Upon Insurance Companies Total Impact</b>				<b>Range = \$35.7 to \$50.1</b>

# NC JUDICIAL DECISIONS THAT HAVE SHAPED NC TAX POLICY

## Overview

*(An in-depth analysis of each of these decisions is attached.)*

### TAXATION OF BUSINESS INCOME

- NC law defines business income as *“income arising from transactions and activity in the regular course of the corporation’s trade or business and includes income from tangible and intangible property if the acquisition, management, and/or disposition of the property constitute integral parts of the corporation’s regular trade or business operations.”*
- The NC Department of Revenue has interpreted this definition to include 2 types of “tests” to determine if a corporation’s income is “business income:”

Transactional Test	Functional Test
<i>Income is business income, if it arises from transactions and activity in the regular course of the corporation’s trade or business.</i>	<i>Income is business income, if it arises from the acquisition, management, and/or disposition of an asset used by the corporation in the regular course of business.</i>

### *Polaroid Corp v. Offerman*

#### Facts:

- Polaroid, a Massachusetts corporation, sued Eastman Kodak for patent infringement.
- \$873 million in damages were awarded to Polaroid.
- **Polaroid claimed** the damages as *nonbusiness* income for NC corporate income tax purposes.
- **NC Department of Revenue claimed** that the damages *were* business income because they met the “functional test”.

Issue	Holding
Does the definition of “business income” contain two distinct tests: a transactional test and functional test?	<b>YES.</b>
Do the damages Polaroid received in the patent infringement suit constitute business income allocable to NC.	<b>YES.</b> The damages were income in lieu of profits, and thus should be classified as business income since they represent the disposition of assets integral to Polaroid’s regular trade or business.

Union Carbide Corporation v. Offerman

**Facts:**

- Union Carbide is domiciled in Connecticut, but conducts business in NC.
- In 1984, to prevent a hostile takeover, it adopted a restructuring plan that included 1) a spin-off of excess funds from its employees' pension fund; and 2) purchasing annuities with spun-off assets to pay benefits to retired employees and distributing the remainder to shareholders to increase stock prices.
  
- **Union Carbide claimed**  
The funds as nonbusiness, thus nontaxable, income on its NC corporate tax return
- **NC Department of Revenue claimed**  
that since the pension plan was an integral part of Union Carbide's business, the reverted funds from the plan were business income.

Issue	Holding
Does the entire reversion of pension plan contributions constitute business income under the functional test?	<b>NO.</b> The reversion of excess funds was not part of Union Carbide's regular trade or business. The funds were investment income.
Since Union Carbide deducted contributions to the fund as business expenses from its business income, shouldn't this reversionary income be treated similarly?	<b>UNCLEAR.</b> The court's decision was unclear whether contributions to pension plans are allowed as deductions against business income.

**FINES & FORFEITURES**

Craven County v. Boyles

**Facts:**

- Weyerhaeuser Company paid a civil penalty of \$962,000 to the NC Department of Environment & Natural Resources for air pollution control violations in Craven County. The money was deposited in the General Fund.
- Craven County Board of Education contended that the civil penalty should have been given to the Craven Co. Bd. of Education based on *Article IX, Sec. 7 of the NC Constitution* which states that the proceeds of all penalties and forfeitures and of all fines collected in the counties for any breach of the penal laws, shall remain in the counties and be used exclusively for the public schools.

Issue	Holding
Was money paid to a State agency pursuant to a settlement for violations of environmental laws a penalty, forfeiture, or fine under Article IX, Sec. 7 of the NC Constitution?	<b>YES.</b> The clear proceeds of all penalties and forfeitures in all cases, regardless of their nature, so long as they accrue to the State, are to be used for the public schools.

Outstanding Issue	
<b><i>Should all administrative fines be paid to local schools?</i></b>	
<p>The NC School Boards Association, and the school boards of Buncombe, Durham, Edgecombe, Johnston, Lenoir, and Wake counties contend that <i>all administrative fines</i> should be paid to local public schools.</p>	<p>The State contends that these administrative fines are <i>not</i> required to be paid to the public schools. Specifically, the fines in question include money collected for:</p> <ul style="list-style-type: none"> <li>• The late payment or underpayment of taxes;</li> <li>• Overweight vehicles and similar violations;</li> <li>• Parking fines collected by the campuses of UNC; and,</li> <li>• The unauthorized substances tax.</li> </ul>

## ECONOMIC & TAX INCENTIVES

### *Maready v. City of Winston-Salem*

**Facts:**

- **NC General Statutes**  
Authorize local governments to make economic development incentive grants to private corporations,
- **NC Constitution**  
Provides that “. . . the power of taxation shall be exercised in a just and equitable manner, *for public purposes only.*” (emphasis added)
- **City of Winston-Salem & Forsyth Co.**  
Invested \$13.2 million in various economic development projects, funded primarily by property taxes.
- **Resident of Winston-Salem**  
Alleged that it was unconstitutional to use public funds to provide economic incentives to businesses.

Issue	Holding
Do NC General Statutes, in allowing local governments to make economic development grants, violate the public purpose clause of the NC Constitution?	<b>NO.</b> The promotion of economic development is a valid public purpose.

Relevance	
What about the taxing power of the State in providing tax breaks, specifically the <i>William S. Lee Quality Jobs and Business Expansion Act</i> , which provides credits, sales tax exemptions, reductions, and refunds to attract businesses to NC?	<i>If</i> the court were asked to determine the constitutionality of the Bill Lee Act, it could consider whether there is a rational basis for giving a tax-break to certain types of businesses and not others, and whether the tax incentives are for a public purpose.

## TAXATION OF FEDERAL, STATE, & LOCAL GOVERNMENT RETIREES

### Bailey, Emory & Patton Class Action Settlement

Prior to 1989:

- All NC State and local retirees had a 100% income tax exemption of their government retirement income.
- Retirees from other states received this exemption *only* to the extent their state would grant an exemption for a NC government retiree.

In 1989:

- NC reduced the exemption from 100% of government retirement income to a maximum of \$4,000, and applied the exemption to *all* government retirees, including those from other states.
- The US Supreme Court ruled that states must treat federal retirees the same as their own state retirees.

#### Facts:

- A class action suit was filed on behalf of all State and local government retirees alleging that the State had breached its contract with them by taxing their retirement benefits.

Issue	Holding
Did the taxation of retirement benefits earned by State and local government retirees who were vested on or before August 12, 1989 constitute a breach of contract?	<b>YES.</b> Taxation of retirement benefits earned and vested before August 12, 1989 was a breach of contract. <i>NOTE:</i> Although the case applied only to State and local retirees, because of the US Supreme Court case which ruled that federal retirees must be treated the same as state retirees, the same relief was granted to those federal retirees.

#### Settlement Amount:

- \$400 million – FY 98-99
- \$399 million – FY 99-00

## INTANGIBLES TAX

### Smith v. State

#### Facts:

- Prior to 1995, NC's intangibles tax law contained an exemption for the proportion of corporate stock equal to the percentage of the corporation's business that was done in NC.
- The law was challenged on the grounds that it unconstitutionally discriminated against interstate commerce.

Issue	Holding
Was NC's prior intangibles tax law which allowed an exemption for the portion of corporate stock equal to the percentage of the corporation's business that was conducted in NC unconstitutional?	<b>YES.</b> The US Supreme Court held that the pre-1995 law violated the Commerce Clause of the US Constitution and remanded the case back to the NC Supreme Court to fashion a remedy.



- **The NC Supreme Court ruled** that the State could go back and tax those shareholders who benefited from the unconstitutional tax.
- but*
- **The NC General Assembly found** retroactive taxation unacceptable, and directed that retroactive intangibles taxes would *not* be collected, therefore, making the State liable for refunds to taxpayers.

The General Assembly passed legislation to issue refunds to taxpayers who had paid under protest, and later approved a settlement agreement to pay \$440 million over next 2 fiscal years to nonprotesters who had sued the State for refunds.

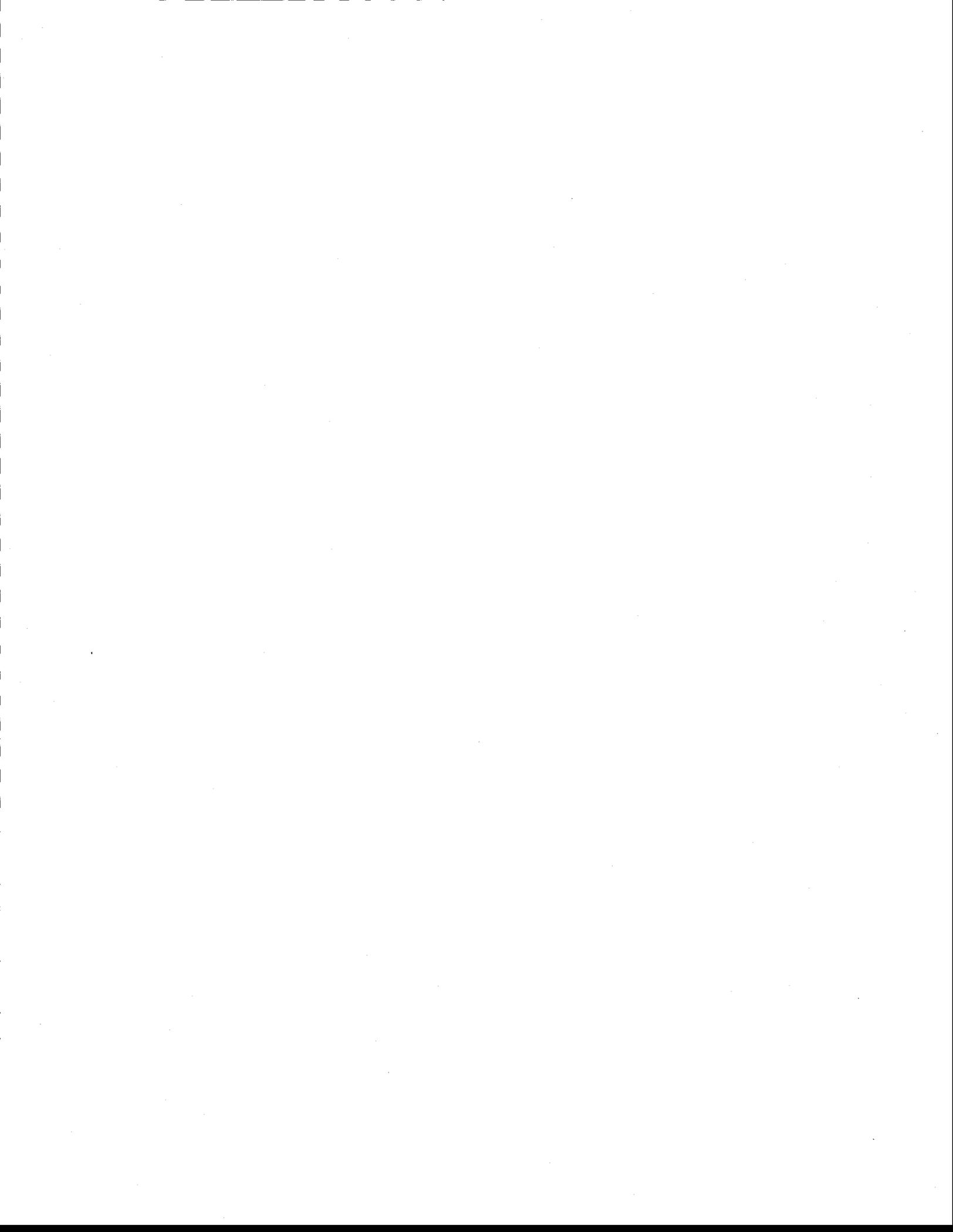
## SCHOOL FUNDING

### *Leandro v. State*

**Facts:**

- Low-wealth school systems and large urban school systems allege that:
  1. The right to adequate educational opportunities is being denied them under the current school funding system; and
  2. The State Constitution guarantees that every child is entitled to equal educational opportunities.

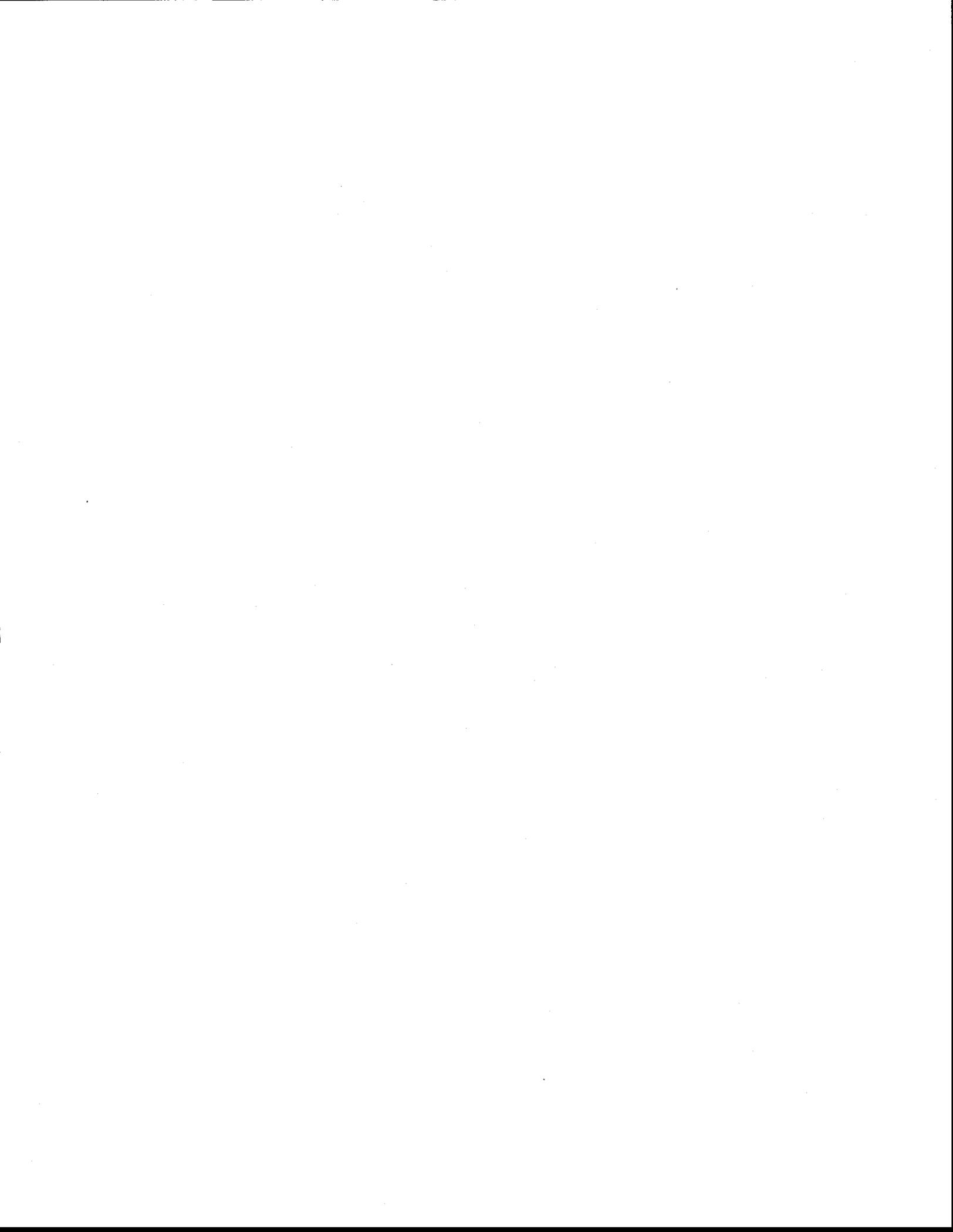
Issue	Holding
Is the State required by the State Constitution to provide children with an education that meets some minimum standard of quality?	<b>YES.</b> The State Constitution guarantees every child the opportunity to receive a sound basic education.
Does the Constitution require substantially equal funding or educational advantages in all school districts.	<b>NO.</b> The State Constitution does not guarantee a right to equal educational opportunities in each of the various school districts of the State.
<b>Outstanding Issue</b>	
<p><b>The Court remanded the case</b> to the trial court to allow those school systems to prove that their students are being denied the right to a sound basic education.</p> <ul style="list-style-type: none"> <li data-bbox="324 1690 1492 1795">• There is a case pending in Wake County Superior Court involving a low-wealth school system (Hoke Co.) which has provided evidence that they need more State money to provide students with a sound basic education.</li> <li data-bbox="324 1795 1492 1837">• There may be a similar trial involving a large urban school system (Wake Co.).</li> </ul>	



# **EXHIBIT I**

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## **Electronic Commerce Issues**



## Electronic Commerce Issues and Initiatives

Tax Policy Commission  
April 13, 2000

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## Sales and Use Taxes

- ◆ Sales tax on retailer
- ◆ Use Tax
  - ◆ Enacted in 1939
  - ◆ Complements the sales tax - use tax is due on transactions on which no sales tax was collected
- ◆ Principles - equal application to same product and tax neutrality

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## Complexity for multistate business

- ◆ Numerous jurisdictions
- ◆ Many different bases
- ◆ Many different rates
- ◆ Many different exemptions
- ◆ Many returns to file
- ◆ Audits by many jurisdictions

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### Typical Use Tax Purchases

- ◆ Mail order
- ◆ TV Home Shopping
- ◆ Telephone
- ◆ Out-of-state
- ◆ Internet

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### Collection of Use Tax

- ◆ Court Decisions - *Bellas Hess* and *Quill*
- ◆ Legislative Actions
  - ◆ Economic Presence Defined (1988)
  - ◆ Voluntary Collection Agreements (1996)
  - ◆ Annual Use Tax Return (1997)
  - ◆ State Vendor Affiliate Program (1999)
  - ◆ Consumer Use Tax Line on Income Tax Return (1999)

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### Internet Tax Freedom Act

- ◆ Created Advisory Commission on Electronic Commerce
- ◆ Prohibits new taxes on access fees for 3-year period
- ◆ Prohibits discriminatory taxes
- ◆ Resulted in rampant confusion
  - ◆ [SalesTaxFree.com](http://SalesTaxFree.com)

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### Advisory Commission on Electronic Commerce

- ◆ 19 members from public and private sector
- ◆ Completed work; no consensus
- ◆ Goal: Promote tax and technological neutrality among all forms of remote commerce
- ◆ Received 35 e-commerce tax proposals
- ◆ Report recommends tax breaks for companies on commission

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### MTC Sales Tax Simplification Project

- ◆ NC Subcommittee
- ◆ Simplification initiatives passed last session
  - ◆ Database for exempt taxpayers
  - ◆ Repeal of \$15 registration fee (allows for on-line or centralized registration)
  - ◆ Electronic filing for semimonthly taxpayers

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### Streamlined Sales Tax System (Zero Burden System)

- ◆ National Governors' Association Proposal
- ◆ Supported by
  - ◆ National Conference of State Legislatures
  - ◆ Council of State Governments
  - ◆ International City/County Management Association
  - ◆ National Association of Counties
  - ◆ National League of Cities
  - ◆ U.S. Conference of Mayors
  - ◆ Federation of Tax Administrators
  - ◆ Multistate Tax Commission

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## Streamlined Sales Tax System

### ◆ Features

- ◆ Simplifying sales and use tax laws and administrative practices
- ◆ Shifting sales tax administration to a technology-oriented business model
- ◆ States assume responsibility for the costs of the system




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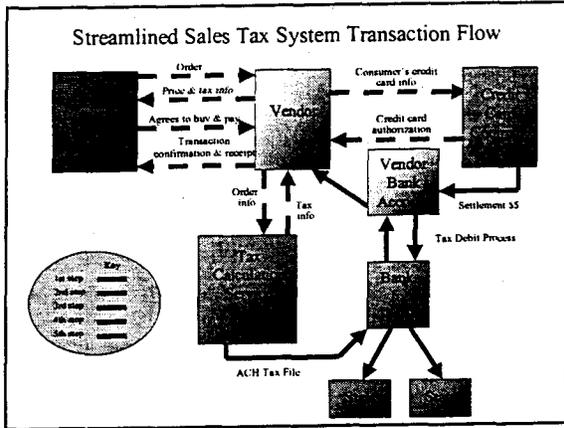
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### Streamlined Sales Tax System Transaction Flow




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## Membership

### ◆ Participating States

- ◆ Support the mission of the project
- ◆ Commitment by elected official

### ◆ Observer States

- ◆ Keep informed of the work of the project
- ◆ Are not opposed to the project
- ◆ Cannot commit now to fulfill the project

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### Participating States

Louisiana	South Dakota
Michigan	Tennessee
Missouri	Utah
Nebraska	Wisconsin
North Carolina	Wyoming

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### Observer States

Arkansas	New Jersey
California	New Mexico
Colorado	North Dakota
Connecticut	Ohio
Idaho	Oklahoma
Illinois	Rhode Island
Iowa	South Carolina
Kansas	Texas
Kentucky	Washington
Minnesota	

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### Project Structure

- ◆ Two Project Co-Chairs
  - ◆ Elected by Participating States
  - ◆ NC and Wisconsin
- ◆ 8-Member Steering Committee
  - ◆ Elected from Participating States
- ◆ Four Workgroups
  - ◆ Tax Base and Exemptions
  - ◆ Technology, Audit, Privacy, and Payment
  - ◆ Tax Rate, Registration, Returns and Remittances
  - ◆ Sourcing and Other Simplification Issues

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**Long-Term Simplification  
Issues**

- ◆ Repeal local tax on food
- ◆ Raise 2% and 3% rates to 6% with same caps
- ◆ Eliminate 1%, \$80 maximum and 1% rates (exempt or tax at 6%)
- ◆ No odd local amount - (6.5% Mecklenburg)
- ◆ Combine local tax and state tax and guarantee distribution to local governments

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# **EXHIBIT J**

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*North Carolina Tax Guide 2000*



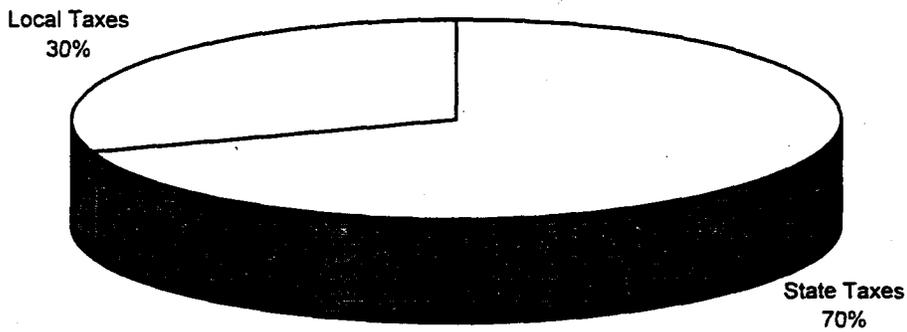
**NORTH CAROLINA**

**TAX GUIDE**

**2000**

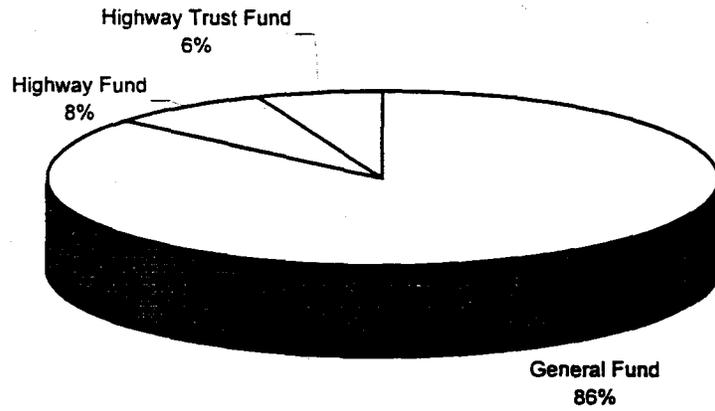
Office of State Budget and Management  
Economic Section  
March 15, 2000

**CHART 1**  
**TAX COLLECTIONS RECEIVED BY NORTH CAROLINA**  
**GOVERNMENTS**  
**(1998-99)**



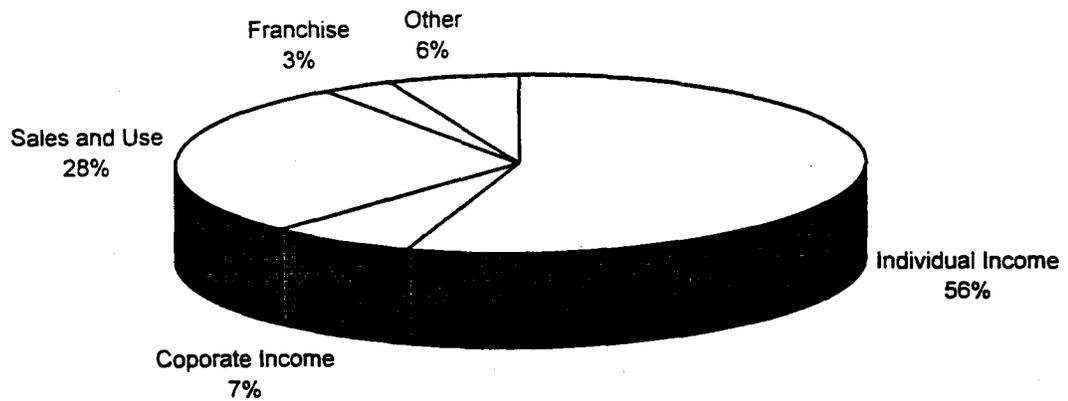
State Taxes	\$13,915,678,473
Local Taxes	6,035,951,738
	<hr/>
Total State and Local Taxes	\$19,951,630,211

CHART 2  
NORTH CAROLINA STATE TAX COLLECTIONS  
(1998-99)



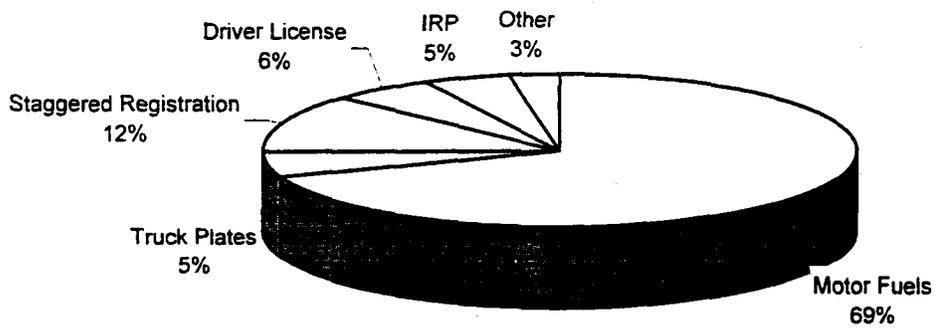
General Fund	\$11,966,224,754
Highway Fund	1,114,947,096
Highway Trust Fund	834,506,623
<b>Total State Tax Revenue</b>	<b>\$13,915,678,473</b>

CHART 3  
 NORTH CAROLINA GENERAL FUND TAX COLLECTIONS  
 (1998-99)



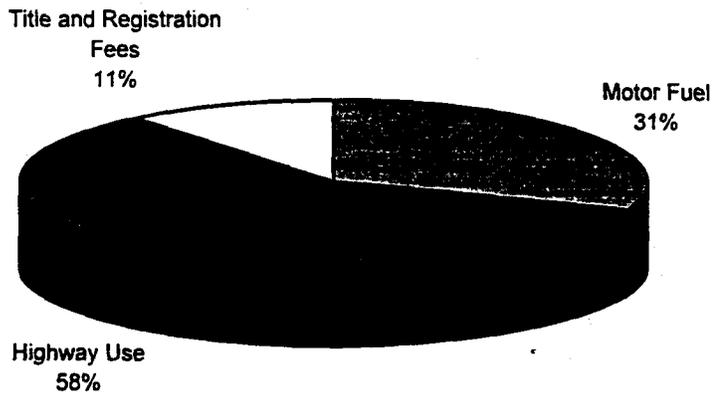
Individual Income	\$6,606,500,278
Corporate Income	848,509,669
Sales and Use	3,376,206,664
Franchise	409,558,340
Other	725,449,803
<b>Total</b>	<b>\$11,966,224,754</b>

CHART 4  
 NORTH CAROLINA HIGHWAY FUND TAX COLLECTIONS  
 (1998-99)



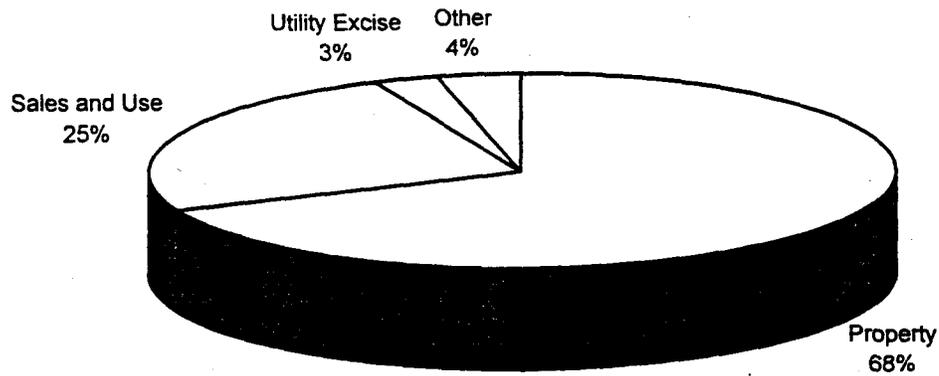
Motor Fuels	\$775,542,096
Truck Plate	56,781,624
Staggered Registration	137,887,521
Driver License	62,278,971
International Registration Plan (IRP)	50,791,801
Other Licenses and Fees	31,665,083
	<hr/>
<b>Total</b>	<b>\$ 1,114,947,096</b>

CHART 5  
 NORTH CAROLINA HIGHWAY TRUST FUND TAX COLLECTIONS  
 (1998-99)



Motor Fuels	\$254,740,680
Highway Use	489,513,431
Title and Registration	90,252,512
<b>Total</b>	<b>\$834,506,623</b>

CHART 6  
 NORTH CAROLINA LOCAL TAX COLLECTIONS  
 RECEIVED BY LOCAL GOVERNMENT  
 (1998-99)



Property	\$4,145,561,429
Sales and Use	1,505,297,284
Utility Excise	161,117,265
Other	223,975,760
	<hr/>
Total	\$6,035,951,738

**NORTH CAROLINA STATUTES**

105-133 to 105-159.1, 105-163.01 to 105-163.09, and 105-163.1 to 105-163.25

**ADMINISTERED BY**

Department of Revenue

<b>Fiscal Year</b>	<b>General Fund Collections</b>	<b>Annual Percent Change</b>	<b>Percent of General Fund Tax Collections</b>
1994-95	4,665,474,733	9.7	49.8
1995-96	4,800,034,948	2.9	50.8
1996-97	5,329,990,261	11.0	52.6
1997-98	6,028,870,217	13.1	54.4
1998-99	6,606,500,278	9.6	55.2

**BASE AND RATE**

The state conforms closely to the federal tax code. The following are some of the additions to the federal definition of taxable income: 1) interest from state and local government obligations other than those of North Carolina and its subdivisions; 2) any amount allowed as a deduction from gross income that is taxed by a separate tax under the Internal Revenue Code (IRC) such as lump sum distributions of certain employees' retirement plans; 3) state, local, and foreign income taxes allowed on federal returns only if total deductions exceed the allowed federal standard deduction; and 4) standard deduction and personal exemption inflation adjustments allowed under the IRC are not automatically authorized under North Carolina law. The following items are not included in North Carolina taxable income: 1) interest from obligations of the United States, North Carolina, or its subdivisions; 2) gain from the disposition of obligations issued before July 1, 1995, to the extent the gain is exempt under North Carolina law; 3) benefits under Title II of the Social Security Act and retirement benefits under the Railroad Retirement Act of 1937; 4) refunds of state, local, and foreign income taxes; 5) maximum of \$4,000 in retirement benefits from one or more federal, state, or local retirement plans if the retiree had less than five years of service as of August 12, 1989, and all retirement benefits excluded if the retiree had more than five years service; and 6) up to \$2,000 in one or more private retirement plans.

Each personal exemption is \$2,500 for a taxpayer whose federal adjusted gross income (AGI) is less than the amounts shown below, and \$2,000 if more than these amounts.

<u>Filing Status</u>	<u>Federal Adjusted Gross Income</u>
Married Filing Joint	\$100,000
Head of Household	80,000
Single	60,000
Married Filing separate	50,000

In addition, an exemption up to \$35,000 in severance pay is granted as a result of the taxpayer's involuntary termination through no fault of the taxpayer. The standard deduction is as follows: 1) married filing joint--\$5,000; 2) married filing separate--\$2,500; 3) head of household with dependent--\$4,400; and 4) single--\$3,000. After allowing for personal exemptions and deductions, the following rate/bracket schedule applies:

#### RATE/BRACKET STRUCTURE

<u>Rate</u>	<u>Married Filing Joint</u>	<u>Married Filing Separate</u>	<u>Head of Household</u>	<u>Single</u>
6.0%	\$ 0 - 21,250	\$ 0 - 10,625	\$ 0 - 17,000	\$ 0 - 12,750
7.0%	21,251 - 100,000	10,626 - 50,000	17,001 - 80,000	12,751 - 60,000
7.75%	100,001 and Above	50,001 and Above	80,001 and Above	60,001 and Above

The following tax credits are allowed: 1) a progressive dependent care credit for qualified expenditures up to a maximum of \$2,400 of expenditures for one dependent and \$4,800 for more than one dependents; 2) \$60 credit for each dependent child; 3) a credit for child health insurance premiums; 4) a credit for taxes paid on certain federal retirement benefits; 5) a credit of 1/3 the amount allowed by federal government for an individual who is totally and permanently disabled; 6) a credit for taxpayer's share of S-corporation income taxes paid in another state that taxes the corporation rather than the shareholder; 7) a tax credit to farmers who permit their crops to be gleaned; 8) a tax credit is for donating an interest in real property to the state, local government, or other qualifying organization for certain land conservation purposes; 9) a 25% credit up to a maximum of \$50,000, for the amount invested in equity securities of a qualified business; 10) a tax credit for qualified rehabilitation expenditures with respect to a certified historic structure; 11) and a partial credit for individuals and corporations using the ports at Wilmington and

Morehead City; 12) a tax credit for taxes paid to another state or country; 13) a tax credit up to maximum of \$550 for the construction of each dwelling for the handicapped that conforms to the North Carolina Building Code; 14) a credit up to a maximum of \$1,000 for property taxes paid on farm machinery; 15) a 7% tax credit for charitable contributions in excess of 2% of adjusted gross income; 16) a 15% tax credit up to \$350 for the premium cost on a qualified long-term care policy; 17) a partial tax credit for the construction of a poultry composting facility; and 18) a 35% tax credit for the cost of renewable energy property up to a maximum of \$250,000 for nonresidential property and \$10,500 for residential property. In addition various tax credits are granted for: a) construction of a solar energy system, b) cost of conversion of an industrial boiler, c) hydroelectric generator, d) solar heat in a manufacturing process, e) wind energy device, f) cost of construction or installation of methane gas facility, and g) certain tillage equipment used for conservation. Further, selected credits are granted for: a) creating jobs in selected industries, b) investing in machinery and equipment, c) research and development expenditures, d) worker training, e) investing in central administrative office property, e) contributions to development zone projects, f) investing in certain business property, and g) investing in low income housing.

## **DISTRIBUTION**

Revenue is deposited in the General Fund for general purposes.

## **TAX CALENDAR**

Returns and tax payments are due by April 15 for income earned during the previous calendar year.

Employers who withhold an average of less than \$500 per month are required to file and remit tax payments quarterly. Payments are due on the last day of the first month following the end of the calendar quarter for withholdings of the previous quarter. Every employer required to deduct and withhold an average of between \$500 and \$2,000 in income taxes per month, and all employers engaged in any business which is seasonal or temporary in nature, shall make returns and payments of such withholdings by the fifteenth day of the month following the month in which such amounts were withheld, except amounts withheld in December which are due on January 31. Employers who withhold an average of over \$2,000 per month are required to remit payments in accordance with the federal withholding payment schedule. Other employers not mentioned above who are required to deduct and withhold income taxes from wages and salaries shall make returns and payments quarterly. Payments are due on the last day of the first month following the end of the calendar quarter for withholdings of the previous quarter.

Estimated income tax payments are required if the taxpayer expects his net estimated tax after withholding and tax credits to be more than \$1,000. Estimated tax payments are due in four installments for the estimated current year's income by April 15, June 15, September 15, and January 15 (for the last quarter of the preceding year).

## TAX ELASTICITY

Individual income tax collections are dependent on the level of state personal income, having an  $R^2 = 0.96$ . That is, 96% of the changes in personal income tax collections are associated with changes in state personal income. Further, personal income is responsive to changes in state personal income, with an estimated income elasticity of 1.14. That is, for every 10% increase in state personal income, individual income tax collections increase by 11.4%.

## COMPARISON WITH OTHER STATES

Forty-three states levy individual income taxes with tax rates, deductions, and exemptions varying widely. North Carolina relies more heavily on the individual income tax than most other states, obtaining 29.9% of its state and local taxes from the individual income tax in 1995-96, as compared to 21.3% for the nation, 16.9% for the 12 Southern states, and 20.4 for the 10 most populated states. Ten states have a higher marginal rate than North Carolina, while 32 have a lower marginal rate. On a national basis, 2.4% of state personal income was devoted to state individual income tax payments. North Carolina citizens devoted 3.2% of their income to individual income tax payments, while taxpayers in the Southeast devoted 1.8%, and those in the eleven largest states 2.3%. In terms of per capita income the average taxpayer in the nation paid \$554 in individual income tax payments, while North Carolina taxpayers paid \$673, and those in the Southeast and the eleven largest state \$364 and \$553 respectively. (Source: *Governmental Finances: 1995-96*, Bureau of the Census, U.S. Department of Commerce, Washington, D.C., 1999, and *State Tax Handbook, 2000*, Commerce Clearing House, Chicago, Illinois, 1999.)

**Table 1.** North Carolina relies more heavily on state government rather than local government taxation than is typical in the nation. In term of state and local government taxation for 1995-96, state government collections averaged 61% for the nation, 64% for the twelve Southeastern states, 59% for the eleven most populated stated, while averaging 72% in North Carolina. North Carolina is the 11<sup>th</sup> most populated state, and ranked 12<sup>th</sup> in total state and local tax collections, 11<sup>th</sup> in state tax collections, and 24<sup>th</sup> in local tax collections.

TABLE 1

LEVEL AND PERCENTAGE DISTRIBUTION OF STATE  
AND LOCAL TAX COLLECTIONS, BY SOURCE, FOR 1995-96  
(\$MILLIONS)

STATES	TOTAL COLLECTIONS			PERCENT DISTRIBUTION	
	TOTAL	STATE GOVERNMENT	LOCAL GOVERNMENT	STATE GOVERNMENT	LOCAL GOVERNMENT
ALABAMA	7,631,749	5,257,771	237397800%	69%	31%
ALASKA	2,301,362	1,519,082	78228000%	66%	34%
ARIZONA	10,162,502	6,409,395	375310700%	63%	37%
ARKANSAS	4,850,399	3,702,141	114825800%	76%	24%
CALIFORNIA	86,214,692	57,746,664	28,468,028	67%	33%
COLORADO	9,243,621	4,820,760	442286100%	52%	48%
CONNECTICUT	12,542,969	7,830,171	471279800%	62%	38%
DELAWARE	2,046,282	1,683,861	36242100%	82%	18%
FLORIDA	33,556,992	19,728,262	1382873000%	59%	41%
GEORGIA	17,308,761	10,292,371	7,016,390	59%	41%
HAWAII	3,841,518	3,079,404	76211400%	80%	20%
IDAHO	2,544,263	1,857,006	68725700%	73%	27%
ILLINOIS	32,613,293	17,508,290	1510500300%	54%	46%
INDIANA	12,979,690	8,437,031	454265900%	65%	35%
IOWA	6,982,600	4,440,540	2,542,060	64%	36%
KANSAS	6,372,805	3,978,761	239404400%	62%	38%
KENTUCKY	8,413,338	6,489,256	192408200%	77%	23%
LOUISIANA	8,465,583	4,906,283	355930000%	58%	42%
MAINE	3,231,393	1,896,564	133482900%	59%	41%
MARYLAND	14,131,690	8,166,692	5,964,998	58%	42%
MASSACHUSETTS	19,122,967	12,455,370	666759700%	65%	35%
MICHIGAN	24,827,513	18,699,069	612844400%	75%	25%
MINNESOTA	14,569,258	10,242,646	432661200%	70%	30%
MISSISSIPPI	5,143,050	3,860,523	128252700%	75%	25%
MISSOURI	11,687,365	7,210,351	4,477,014	62%	38%

Table 1: Continued

TABLE 1

**LEVEL AND PERCENTAGE DISTRIBUTION OF STATE  
AND LOCAL TAX COLLECTIONS, BY SOURCE, FOR 1995-96  
(\$MILLIONS)**

STATES	TOTAL COLLECTIONS			PERCENT DISTRIBUTION	
	TOTAL	STATE GOVERNMENT	LOCAL GOVERNMENT	STATE GOVERNMENT	LOCAL GOVERNMENT
MONTANA	1,782,111	1,211,162	570,949	68%	32%
NEBRASKA	4,181,433	2,369,462	1,811,971	57%	43%
NEVADA	4,266,098	2,895,346	1,370,752	68%	32%
NEW HAMPSHIRE	2,618,777	837,092	1,781,685	32%	68%
NEW JERSEY	27,449,361	14,384,897	13,064,464	52%	48%
NEW MEXICO	3,876,174	3,060,637	815,537	79%	21%
NEW YORK	72,495,173	34,150,039	38,345,134	47%	53%
NORTH CAROLINA	16,486,228	11,882,318	4,603,910	72%	28%
NORTH DAKOTA	1,441,143	985,327	455,816	68%	32%
OHIO	27,961,467	15,649,492	12,311,975	56%	44%
OKLAHOMA	6,558,470	4,617,688	1,940,782	70%	30%
OREGON	7,238,030	4,351,035	2,886,995	60%	40%
PENNSYLVANIA	30,243,954	18,259,012	11,984,942	60%	40%
RHODE ISLAND	2,710,669	1,553,930	1,156,739	57%	43%
SOUTH CAROLINA	7,328,128	5,113,034	2,215,094	70%	30%
SOUTH DAKOTA	1,438,255	730,251	708,004	51%	49%
TENNESSEE	9,992,422	6,179,787	3,812,635	62%	38%
TEXAS	40,704,512	21,611,887	19,092,625	53%	47%
UTAH	4,293,575	2,905,128	1,388,447	68%	32%
VERMONT	1,517,686	841,029	676,657	55%	45%
VIRGINIA	15,626,150	8,900,413	6,725,737	57%	43%
WASHINGTON	15,466,559	10,586,463	4,880,096	68%	32%
WEST VIRGINIA	3,642,757	2,764,522	878,235	76%	24%
WISCONSIN	15,205,413	9,585,513	5,619,900	63%	37%
WYOMING	1,164,841	710,512	454,329	61%	39%
UNITED STATES	689,038,310	420,477,109	270,601,514	61%	39%

Source: *Governmental Finances: 1995-96*, Bureau of the Census, U.S. Department of Commerce, Washington, D.C., 1999.

**Table 2.** North Carolina has a lower state and local tax burden than the average state in the nation. The state has a very low local tax burden, while the state tax burden is above average. In 1995-96, North Carolina ranked 33rd in the nation in state and local per capita tax burden, 17th in per capita state tax burden, and 40th in per capita local tax burden. As a percent of personal income, North Carolina ranked 33th in state and local tax burden, 17th in state tax burden, and 42nd in local tax burden.

TABLE 2

STATE RANKING OF STATE AND LOCAL TAX BURDEN,  
PER CAPITA AND PERCENT OF PERSONAL INCOME, FOR 1995-96

STATES	PER CAPITA			PERCENT OF PERSONAL INCOME		
	TOTAL	STATE	LOCAL	TOTAL	STATE	LOCAL
ALABAMA	50	45	44	48	37	43
ALASKA	3	3	6	1	3	7
ARIZONA	29	30	30	15	25	20
ARKANSAS	47	28	50	34	13	49
CALIFORNIA	14	13	26	24	20	34
COLORADO	25	44	9	41	48	12
CONNECTICUT	2	4	5	12	23	17
DELAWARE	9	5	45	32	6	50
FLORIDA	28	40	20	42	43	26
GEORGIA	26	36	21	29	36	19
HAWAII	5	2	38	6	1	1
IDAHO	39	20	43	18	10	41
ILLINOIS	12	1	4	30	2	5
INDIANA	35	31	33	40	32	36
IOWA	23	21	27	16	24	22
KANSAS	22	22	23	23	29	23
KENTUCKY	37	16	46	19	7	48
LOUISIANA	46	48	32	43	44	21
MAINE	16	24	15	7	19	8
MARYLAND	11	18	7	37	42	18
MASSACHUSETTS	6	7	13	26	27	28
MICHIGAN	17	8	39	31	15	46
MINNESOTA	7	6	24	5	5	29
MISSISSIPPI	48	34	49	22	8	44
MISSOURI	36	42	31	46	41	31

Table 2: Continued

TABLE 2

**STATE RANKING OF STATE AND LOCAL TAX BURDEN,  
PER CAPITA AND PERCENT OF PERSONAL INCOME, FOR 1995-96**

STATES	PER CAPITA			PERCENT OF PERSONAL INCOME		
	TOTAL	STATE	LOCAL	TOTAL	STATE	LOCAL
MONTANA	41	39	37	28	22	37
NEBRASKA	19	32	12	14	34	9
NEVADA	15	14	29	21	18	35
NEW HAMPSHIRE	32	50	3	50	50	4
NEW JERSEY	4	12	2	3	30	3
NEW MEXICO	30	15	48	8	4	47
NEW YORK	1	10	1	2	31	2
NORTH CAROLINA	33	17	40	33	17	42
NORTH DAKOTA	34	23	35	11	12	32
OHIO	21	35	11	27	40	13
OKLAHOMA	43	37	42	35	21	39
OREGON	31	41	25	36	39	24
PENNSYLVANIA	20	25	18	38	38	27
RHODE ISLAND	13	19	8	20	35	14
SOUTH CAROLINA	44	49	41	39	26	40
SOUTH DAKOTA	45	38	19	45	49	10
TENNESSEE	49	46	34	49	46	38
TEXAS	40	47	17	44	47	15
UTAH	38	29	36	10	16	30
VERMONT	18	33	10	9	33	6
VIRGINIA	27	43	16	47	45	25
WASHINGTON	10	9	28	13	14	33
WEST VIRGINIA	42	26	47	25	9	45
WISCONSIN	8	11	14	4	11	11
WYOMING	24	27	22	17	28	16

Source: Statistics presented in this table are based on data found in *Governmental Finances: 1995-96*, Bureau of Census, U.S. Department of Commerce, Washington, D.C., 1999.

**Table 3.** States tax decreases were larger than tax increases during each legislative session from 1995 through 1998. During that four year period, net tax decreases totaled \$14.9 billion, or 1% of total collections. As computed by the National Council of State Legislatures, North Carolina enacted \$862.3 million in net tax decreases, representing 2% of its tax collections. Only ten states decreased taxes by a larger percent.

TABLE 3

**ESTIMATED IMPACT OF RECENT TAX CHANGES IN THE  
UNITED STATES ENACTED IN 1994-95, 1995-96, 1996-97, AND 1997-98  
(\$MILLIONS, %CHANGE)**

STATES	1998 LEGISLATION		1997 LEGISLATION		1996 LEGISLATION		1995 LEGISLATION	
	NET CHANGE FY1999	PERCENT OF 1997 TAXES	NET CHANGE FY1998	PERCENT OF 1996 TAXES	NET CHANGE FY1997	PERCENT OF 1995 TAXES	NET CHANGE FY1996	PERCENT OF 1994 TAXES
MONTANA	1.3	0.1	-53.4	-4.3	0	0	-31.3	-2.6
NEBRASKA	-109.6	-4.3	-88.3	-3.7	1.1	0.1	3.7	0.2
NEVADA	0	0	0	0	0	0	-15	-0.7
NEW HAMPSHIRE	0	0	20.1	2.4	0	0	-126.1	-15.4
NEW JERSEY	-76.3	-0.5	-1.5	0	-143	-1.1	-260	-2
NEW MEXICO	-20.6	-0.7	16	0.5	9.2	0.3	-25.1	-0.9
NEW YORK	-98	-0.3	-803.5	-2.4	-1,971.0	-6	-944	-0.8
NORTH CAROLINA	-96.8	-0.8	-309.9	-2.6	-88.8	-0.8	-363.3	-3.6
NORTH DAKOTA	0	0	-0.7	-0.1	4.3	0.5	0	0
OHIO	-708.6	-4.3	-22.5	-0.1	-425	-3	-67.9	-0.5
OKLAHOMA	-15.9	-0.3	0	0	-0.6	0	0	0
OREGON	0	0	67.3	1.5	0	0	-291.7	-7.5
PENNSYLVANIA	-204.4	-1.1	76	0.4	10.1	0.1	-281	-1.7
RHODE ISLAND	-45.4	-2.8	49.5	5.9	-4.4	-0.3	-28.3	-2
SOUTH CAROLINA	11.9	0.2	-3.7	-0.1	-10	-0.2	-14.6	-0.3
SOUTH DAKOTA	0	0	16.8	2.3	0	0	27	4.5
TENNESSEE	0	0	0	0	0	0	-9.4	-0.2
TEXAS	0	0	35.9	0.2	0	0	7.3	0
UTAH	0	0	45	1.5	-53.7	-2.2	-83.6	-3.5
VERMONT	-0.8	-0.1	49.5	5.9	1	0.1	21.1	2.6
VIRGINIA	-142.2	-1.5	3.5	0	0	0	-26.2	-0.3
WASHINGTON	-19.7	-0.2	-6.5	-0.1	-132.6	-1.4	-11.4	-0.1
WEST VIRGINIA	-5	-0.2	-8.6	-0.3	-6.5	-0.3	-3	-0.1
WISCONSIN	-123.5	-1.2	50.6	0.5	43.5	0.5	29.8	0.4
WYOMING	35.4	5.3	0	0	0	0	0	0
UNITED STATES	-7,142.0	-1.6	-2,573.1	-0.6	-4,030.2	-1.1	-1,210.6	-0.3

Source: State Tax Actions--1998, 1997, 1996, and 1995, National Council of State Legislatures, Denver, Colorado, January 1999, February 1998, October 1996, and December, 1995, pp. 11, 14-15, 4-15, 12-1 respectively.

TABLE 3

**ESTIMATED IMPACT OF RECENT TAX CHANGES IN THE  
UNITED STATES ENACTED IN 1994-95, 1995-96, 1996-97, AND 1997-98  
(\$MILLIONS, %CHANGE)**

STATES	1998 LEGISLATION		1997 LEGISLATION		1996 LEGISLATION		1995 LEGISLATION	
	NET CHANGE FY1999	PERCENT OF 1997 TAXES	NET CHANGE FY1998	PERCENT OF 1996 TAXES	NET CHANGE FY1997	PERCENT OF 1995 TAXES	NET CHANGE FY1996	PERCENT OF 1994 TAXES
ALABAMA	4.5	0.1	0	0	-2.4	-0.1	0	0
ALASKA	-5.1	-0.3	24.1	1.6	0	0	0	0
ARIZONA	-125.4	-1.8	-109.9	-1.7	-175.3	-3.1	-168.6	-3.1
ARKANSAS	0	0	31.5	0.8	0	0	-25	-0.8
CALIFORNIA	-1331.4	-2.2	-170	-0.3	-94	-0.2	-255	-0.5
COLORADO	-564.2	-10.7	-142.1	-2.9	-17.7	-0.4	0	0
CONNECTICUT	-94.1	-4.7	-127	-1.6	-268	-3.9	63.5	1.2
DELAWARE	-48.2	-2.8	-2	-0.1	-12.5	-0.9	-18.4	-1.4
FLORIDA	-133	-0.6	-48.6	-0.2	-32.6	-0.2	4	0
GEORGIA	-275.3	-2.5	-154.6	-1.5	-172	-2	0	0
HAWAII	-64	-2.1	0.2	0	0	0	65	2.3
IDAHO	-2.8	-0.1	0	0	27.6	1.7	0	0
ILLINOIS	-117	-0.6	115	0.7	-9.1	-0.1	-110	-0.8
INDIANA	-2.3	0	-50.9	-0.6	-264.4	-3.6	0	0
IOWA	-101.5	-2.2	-132.7	-3	-23.3	-0.6	-31.5	-0.7
KANSAS	-224.7	-5.3	-114.9	-2.9	-8.8	-0.2	-39.5	-1.2
KENTUCKY	-67.1	-1	-13.8	-0.2	-44.3	-0.8	-34	-0.6
LOUISIANA	-8.6	-0.2	-118	-2.4	-6.1	-0.1	0	0
MAINE	-94.1	-4.7	110.8	5.8	-11.4	-0.6	3.6	0.2
MARYLAND	-200.2	-2.3	-39.5	-0.5	-1.5	0	-4.5	-0.1
MASSACHUSETTS	-691.5	-5.2	-188.7	-1.5	-195	-1.8	-0.7	0
MICHIGAN	-46	-0.2	148.5	0.8	-13.9	-0.1	-245	-2
MINNESOTA	-488.7	-4.4	-475.6	-4.7	-8.8	-0.2	8.1	0.1
MISSISSIPPI	-15.1	-0.4	-2.4	-0.1	0	0	6	0.2
MISSOURI	-454	-5.8	-163.3	-2.2	65	1.1	0	0

Table 3: Continued

**Table 4.** North Carolina's per capita state and local tax burden was \$2,251, while it averaged \$2,597 for the nation, and \$2,152 in the Southeast. Of the twelve Southeastern states, North Carolina ranked fourth in per capita state and local tax burden. As a percent of personal income, North Carolina's state and local tax burden stood at 10.9%, while the burden was 11.3%, for the nation, and 10.4% in the Southeast. Of the twelve Southeastern states, North Carolina ranked fifth in state and local tax burden as a percent of personal income.

TABLE 4

**STATE AND LOCAL TAX COLLECTIONS, PER CAPITA AND  
AS A PERCENT OF PERSONAL INCOME, BY SOURCE, FOR THE  
TES, SOUTHEAST, AND NORTH CAROLINA, FOR 1995-96**

STATES	PER CAPITA			PERCENT OF PERSONAL INCOME		
	TOTAL	STATE	LOCAL	TOTAL	STATE	LOCAL
UNITED STATES	2,597	1,577	1,020	11.3	6.9	4.4
SOUTHEAST	2,152	1,385	767	10.4	6.7	3.7
ALABAMA	1,786	1,230	556	9.4	6.4	2.9
ARKANSAS	1,932	1,475	457	10.8	8.2	2.6
FLORIDA	2,330	1,370	961	10.3	6	4.2
GEORGIA	2,354	1,400	954	11.1	6.6	4.5
KENTUCKY	2,166	1,671	495	11.6	8.9	2.7
LOUISIANA	1,946	1,128	817	10.3	6	4.4
MISSISSIPPI	1,894	1,421	472	11.4	8.6	2.9
<b>NORTH CAROLINA</b>	<b>2,251</b>	<b>1,623</b>	<b>630</b>	<b>10.9</b>	<b>7.8</b>	<b>3.1</b>
SOUTH CAROLINA	1,981	1,382	600	10.5	7.3	3.2
TENNESSEE	1,878	1,162	717	9	5.6	3.4
VIRGINIA	2,341	1,333	1,007	9.8	5.6	4.2
WEST VIRGINIA	1,995	1,514	481	11.3	8.6	2.7

Source: Statistics presented in this table are based on data found in Governmental Finances: 1995-96, Bureau of Census, U.S. Department of Commerce, Washington, D.C., 1999.

**Table 5.** North Carolina taxpayers have a lower state and local tax burden than the average citizen in the eleven most populated states, and a tax lower burden than the average national taxpayer. In 1995-96, on a per capita basis, taxpayers in North Carolina paid \$2,251 in state and local taxes, while the per capita state and local tax burden in the eleven most populated states stood at \$2,718, and the national average was \$2,597. Of the eleven most populated states, North Carolina had the second lowest per capita tax burden. Further, while North Carolina taxpayers allocated 10.9% of their income to state and local tax payments, taxpayers in the eleven most populated states allocated 11.5%, and the average taxpayer in the nation allocated 11.3%. Of the eleven most populated states, five states had a higher tax burden, as measured as a percent of personal income, three the same (including North Carolina), three lower.

TABLE 5

**STATE AND LOCAL TAX COLLECTIONS, PER CAPITA AND AS A PERCENT  
OF PERSONAL INCOME, BY SOURCE, FOR THE UNITED STATES  
AND THE ELEVEN MOST POPULATED STATES, FOR 1995-96**

STATES	PER CAPITA			PERCENT OF PERSONAL INCOME		
	TOTAL	STATE	LOCAL	TOTAL	STATE	LOCAL
UNITED STATES	2,597	1,577	1,020	11.3	6.9	4.4
ELEVEN LARGEST STATES	2,718	1,591	1,127	11.5	6.7	4.8
CALIFORNIA	2,705	1,811	893	11.3	7.6	3.7
FLORIDA	2,330	1,370	961	10.3	6.0	4.2
GEORGIA	2,354	1,400	954	11.1	6.6	4.5
ILLINOIS	2,753	1,478	1,275	10.9	5.9	5.1
MICHIGAN	2,588	1,949	640	10.9	8.2	2.7
NEW JERSEY	3,484	1,826	1,658	13.4	7.0	6.4
NEW YORK	3,987	1,878	2,109	14.4	6.8	7.6
<b>NORTH CAROLINA</b>	<b>2,251</b>	<b>1,623</b>	<b>629</b>	<b>10.9</b>	<b>7.8</b>	<b>3.1</b>
OHIO	2,503	1,401	1,102	11.1	6.2	4.9
PENNSYLVANIA	2,509	1,515	995	10.6	6.4	4.2
TEXAS	2,128	1,130	997	10.3	5.4	4.8

Source: Statistics presented in this table are based on data found in Governmental Finances: 1995-96, Bureau of Census, U.S. Department of Commerce, Washington, D.C., 1999.

**Table 6.** North Carolina relies more heavily on the individual income tax than the average state in the nation or the Southeast. Whereas the individual income tax makes up 29.9% of total state and local taxes in North Carolina, it makes up only 21.3% for the nation, and 16.9% in the Southeast. Most Southeastern states rely heavily on the sales and use tax, which make-up 30.5% of collections. This compares to 24.5% in the United States and 23.4% in North Carolina. On the other hand, North Carolina relies less heavily on property taxes than most states. Property taxes consists of 30.4% of state and local tax collections in the nation, 27.4% in the Southeast, and 21% in North Carolina.

TABLE 6

**PERCENTAGE DISTRIBUTION OF STATE AND LOCAL TAXES,  
BY TYPE OF TAX, FOR THE UNITED STATES, SOUTHEAST,  
AND NORTH CAROLINA , FOR 1995-96**

PERCENTAGE DISTRIBUTION			
REVENUE SOURCE	UNITED STATES	SOUTHEAST	NORTH CAROLINA
INDIVIDUAL INCOME	21.3	16.9	29.9
SALES AND USE	24.5	30.5	23.4
PROPERTY	30.4	27.4	21.0
CORPORATE INCOME	4.6	3.8	5.7
MOTOR FUELS	3.9	5.3	5.8
MOTOR VEHICLE LICENSE	2.0	2.1	2.2
OTHER	13.3	14.0	12.0
TOTAL TAX	100.0	100.0	100.0

Source: Statistics presented in this table are based on data found in Governmental Finances: 1995-96, Bureau of the Census, U.S. Department of Commerce, Washington, D.C., 1999.

**Table 7.** North Carolina relies more heavily on the individual income tax than the average state in the nation or the eleven most populated states. Whereas the individual income tax makes up 29.9% of total state and local taxes in North Carolina, it makes up only 21.3% in the nation, and 20.4% in the eleven most populated states. Most of the largest states rely heavily on the property tax, which make-up 31.8% of collections. This compares to 30.4% in the United States, and 21% in North Carolina. Dependence on sales and use tax collections are similar, with these revenue consisting of 24.5% of state and local tax collections in the nation, 24.2% in the eleven most populated states, and 23.4% in North Carolina.

TABLE 7

**PERCENTAGE DISTRIBUTION OF STATE AND LOCAL TAXES,  
BY TYPE OF TAX, FOR THE UNITED STATES, ELEVEN MOST  
POPULATED STATES, AND NORTH CAROLINA , FOR 1995-96**

REVENUE SOURCE	PERCENTAGE DISTRIBUTION		
	UNITED STATES	ELEVEN LARGEST STATES	NORTH CAROLINA
INDIVIDUAL INCOME	21.3	20.4	29.9
SALES AND USE	24.5	24.2	23.4
PROPERTY	30.4	31.8	21.0
CORPORATE INCOME	4.6	5.1	5.7
MOTOR FUELS	3.9	3.3	5.8
MOTOR VEHICLE LICENSE	2.0	1.8	2.2
OTHER	13.3	13.4	12.0
TOTAL TAX	100.0	100.0	100.0

Source: Statistics presented in this table are based on data found in Governmental Finances: 1995-96, Bureau of the Census, U.S. Department of Commerce, Washington, D.C., 1999.

**Table 8.** North Carolina's per capita state and local tax burden is lower than that in the nation, but higher than that in Southeast. In 1995-96, North Carolina's per capita tax burden was \$2,251, as compared to \$2,597 in the United States, and \$2,251 in the Southeast. As a percent of personal income, North Carolina's state and local tax burden was 10.9%, as compared to 11.3% in the nation, and 10.4% in the Southeast. As is evident from the Table, North Carolina has a higher individual income and motor fuels tax burden than the average for the nation and the Southeast, while having a lower sales and use and property tax burden.

TABLE 8

**STATE AND LOCAL TAX COLLECTIONS, PER CAPITA AND AS  
A PERCENT OF PERSONAL INCOME, BY TYPE OF TAX, FOR THE  
UNITED STATES, SOUTHEAST, AND NORTH CAROLINA, FOR 1995-96**

REVENUE SOURCE	PER CAPITA			PERSONAL INCOME		
	UNITED STATES	SOUTH-EAST	NORTH CAROLINA	UNITED STATES	SOUTH-EAST	NORTH CAROLINA
INDIVIDUAL INCOME	554	364	673	2.4	1.8	3.2
SALES AND USE	637	657	526	2.8	3.2	2.5
PROPERTY	789	590	472	3.4	2.8	2.3
CORPORATE INCOME	121	83	128	0.5	0.4	0.6
MOTOR FUELS	101	114	130	0.4	0.6	0.6
MOTOR VEHICLE LICENSE	52	45	49	0.2	0.2	0.2
OTHER	516	427	450	2.2	2.1	2.2
TOTAL TAX	2,597	2,152	2,251	11.3	10.4	10.9

Source: Statistics presented in this table are based on data found in Governmental Finances: 1995-96, Bureau of the Census, U.S. Department of Commerce, Washington, D.C., 1999.

**Table 9.** North Carolina's per capita state and local tax burden is lower than that in the nation and significantly lower than the average of the eleven most populated states. In 1995-96, North Carolina's per capita tax burden was \$2,251, as compared to \$2,597 for the United States, and \$2,736 for the eleven most populated states. As a percent of personal income, North Carolina's state and local tax burden was 10.9%, as compared to 11.3% for the nation, and 11.5% for the eleven most populated states. As is evident from the Table, North Carolina has a higher individual income and motor fuels tax burden than the national and the eleven most populated states, but a lower sales and use and property tax burden.

TABLE 9

**STATE AND LOCAL TAX COLLECTIONS, PER CAPITA AND AS A PERCENT  
OF PERSONAL INCOME, BY SOURCE, FOR THE UNITED STATES  
AND THE ELEVEN MOST POPULATED STATES, FOR 1995-96**

REVENUE SOURCE	PER CAPITA			PERSONAL INCOME		
	UNITED STATES	ELEVEN LARGEST STATES	NORTH CAROLINA	UNITED STATES	ELEVEN LARGEST STATES	NORTH CAROLINA
INDIVIDUAL INCOME	554	553	673	2.4	2.3	3.2
SALES AND USE	637	656	526	2.8	2.8	2.5
PROPERTY	789	876	472	3.4	3.7	2.3
MOTOR FUELS	101	90	130	0.4	0.4	0.6
OTHER	516	563	450	2.2	2.4	2.2
TOTAL TAX	2,597	2,736	2,251	11.3	11.5	10.9

Source: Statistics presented in this table are based on data found in Governmental Finances: 1995-96, Bureau of the Census, U.S. Department of Commerce, Washington, D.C., 1999.

